Santa Fe Industries, Inc. **1981 Annual Report**

Transportation

Natural Resources

Forest Products

Real Estate and Construction

Santa Fe Industries, Inc., is a diversified company active in four major business areas: transportation, natural resources, forest products, and real estate and construction.

The Company was formed in 1968 as the parent company of The Atchison, Topeka and Santa Fe Railway Company and other subsidiaries to provide the organizational structure for more fully developing non-railroad operations, while continuing a strong and efficient rail transportation service. This diversification is increasingly important in today's volatile economic environment.

Transportation

Rail, truck, and pipeline systems provide the Company with a broad base in transportation.

The Atchison, Topeka and Santa Fe Railway Company, one of the nation's major railroads, extends from Chicago to the Gulf of Mexico and the Pacific Coast across the midwestern and southwestern United States.

The Santa Fe Trail Transportation Company conducts trucking operations in eighteen states, including much of the same territory as the Railway.

Gulf Central Pipeline Company delivers anhydrous ammonia fertilizer from points in Louisiana to the Corn Belt states. Chaparral Pipeline transports natural gas liquids across Texas to the Houston area.

Natural Resources

Santa Fe's natural resources activities encompass petroleum and hard minerals exploration and development.

Santa Fe Energy Company is one of the largest producers of heavy oil in the country. Oil and gas exploration and development are pursued through onshore operations, including the application of enhanced recovery techniques, and through participation in offshore joint ventures. Santa Fe Energy Products Company is an active marketer of petroleum products.

With more than four million acres of mineral rights in the Southwest, the Company derives a growing income from coal and uranium royalties. Santa Fe Mining, Inc., is actively searching for new opportunities.

Forest Products

Southern pine plywood, lumber, particleboard and other wood products are produced and marketed throughout Texas and the South.

Kirby Forest Industries, Inc., produces the major part of the wood fiber it needs from its 655,000 acres of forests in eastern Texas and southwestern Louisiana.

Sustained-yield forestry programs provide a continuing supply of this uniquely renewable resource.

Walker-Kurth Lumber Company is a building products chain serving both wholesale and retail customers in southeastern Texas.

Real Estate and Construction

Santa Fe is involved in general contracting along with development of industrial and commercial properties.

Working with a land bank of about 22,000 acres, Santa Fe Realty, Inc., manages, develops and markets property throughout the Southwest.

Robert E. McKee, Inc., is a major general contractor which builds offices, schools, airports, hospitals, and industrial plants throughout the Sun Belt.

The Zia Company and its subsidiaries provide support services to the U.S. Department of Energy at Los Alamos, New Mexico.

Financial Highlights

For The Year (In Millions)	1981	1980	Percent Change
Revenues and Sales	$3,366.9	$3,122.8(1)	7.8
Net Income	242.2	301.8	(19.7)
Capital Expenditures	563.9	494.3	14.1
Depreciation, Depletion and Amortization	184.6	145.0	27.3
Wages, Salaries and Benefits	1,346.0	1,236.3	8.9
At Year End (In Millions)			
Total Assets	$4,677.8	$4,330.2	8.0
Working Capital	174.8	169.8	2.9
Long Term Debt Due After One Year	720.8	752.9	(4.3)
Stockholders' Equity	2,471.5	2,305.5	7.2
Per Common Share (2)			
Net Income			
Primary	$ 2.73	$ 3.47	(21.3)
Fully Diluted	2.68	3.35	(20.0)
Dividends Declared	1.00	.90	11.1
Stockholders' Equity	27.73	26.21	5.8

(1) Restated to reflect the trading activities of the petroleum marketing operations on a net basis.
(2) Restated for three-for-one stock split effective May 11, 1981.

Contribution to Consolidated Pre-tax Income

	1981	1980(1)	1979	1978	1977	1976	1975	1974	1973	1972
Transportation										(In Millions)
Rail	$110.4	$193.9	$124.9	$100.0	$ 61.4	$ 47.5	$ 51.2	$ 76.8	$ 84.6	$ 88.0
Pipeline	23.9	18.1	11.7	10.0	11.9	3.2	(.1)	(5.0)	(6.3)	(7.3)
Other	1.7	(1.0)	(1.2)	1.3	1.6	(.6)	(1.6)	(.9)	(2.6)	(2.1)
Natural Resources										
Petroleum Production	123.8	146.5	95.9	43.0	63.0	75.0	82.3	71.6	32.3	22.3
Petroleum Marketing	2.0	3.2	1.6							
Hard Minerals	9.0	9.3	7.8	9.8	8.8	3.0	1.3	.5	.8	.9
Forest Products	1.2	8.6	15.3	22.8	21.9	11.9	5.1	5.2	7.0	4.4
Real Estate and Construction	32.0	42.2	25.6	19.4	19.8	13.2	6.4	7.7	13.2	9.8
Other Income—Net	28.6	23.0	34.5	34.2	35.4	21.6	12.3	19.9	22.2	9.9
Unallocated Interest Expense	(1.2)	(2.4)	(3.1)	(3.8)	(5.3)	(6.5)	(6.8)	(6.8)	(6.8)	(6.7)
Total	$331.4	$441.4	$313.0	$236.7	$218.5	$168.3	$150.1	$169.0	$144.4	$119.2

(1) Restated to reflect state income tax separately. Years prior to 1980 have not been restated due to immateriality of amounts involved.
See Note 12 to financial statements for additional information on business segments.

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To Our Stockholders

The economic recession during the latter half of 1981 was largely responsible for a break in Santa Fe's string of record earnings which had run for five consecutive years and had produced the cumulative effect of tripling net income from 1975 to 1980, but the 1981 results were still the second best in our history. Net income for Santa Fe Industries in 1981 was $242 million, a decrease of 20% from 1980. On a primary basis, net income per share was $2.73, compared with $3.47 a year earlier.

Economic conditions impacted nearly all of our operations, with our two prime areas—railroading and petroleum operations—being particularly affected. Early in the year we experienced record high rail traffic and strong crude oil prices, and it appeared we would have another banner year. This bright outlook faded during the third quarter, however, and changing conditions seriously impacted the fourth quarter, when our net income was down 47%.

As the nation's economic activity spiraled downward, the volume of freight shipments also declined. The resulting temporary overcapacity within the railroad industry coincided with the greater pricing freedom granted railroads under the Staggers Rail Act of 1980. This combination led to price-cutting by some railroads in an effort to attract a larger market share. Santa Fe Railway was affected primarily in the areas of grain and intermodal traffic.

As a leader in both intermodal and grain traffic in our market area, it was difficult to escape the economic impact of intensified competition which was the inevitable result of the legislation permitting railways to manage their business with less government interference. In the long run, it is felt that this new environment will more than compensate for our temporary situation—one which should stabilize as the economy improves.

With respect to Santa Fe's petroleum operations, the worldwide improvement in the supply of petroleum caused oil prices to taper off from the mid-year high. There was, however, no decrease in the escalating costs of finding and producing oil. Furthermore, the Windfall Profit Tax, which is in reality an excise tax, continued to take a large bite.

A significant portion of our petroleum reserves was acquired many years ago at a relatively low cost. Many of these older reserves were at shallow depths, and could be produced at a reasonable cost. Petroleum is a depleting resource, however, which must constantly be replaced. Costs today for acquiring leases, exploratory drilling, and development are much higher, especially for offshore and enhanced recovery activities. Petroleum will continue to be an attractive business for Santa Fe, but if world demand remains flat for some time, as is widely predicted, it is doubtful that those engaged in oil production will experience the same degree of profitability that was enjoyed in the late 1970s.

John S. Reed *John J. Schmidt*

Our forest products group and real estate activities felt the effects of the recession, as well as the high level of interest rates and increased cost of doing business, and produced substantially poorer results than in 1980. By contrast, the pipeline group handled record volumes and produced record earnings.

The Administration's program to combat inflation has been blamed by some for prolonging the recession, but there seems little doubt that bringing inflation under control should remain a top priority. Current efforts by government and the private sector will need time to reverse the recent trends of declining productivity, increased diversion of public funds into non-productive endeavors, and diminishing the incentive to invest in productive facilities. As we come out of the recession, these efforts should result in a stronger basic business climate.

The public seems to be recognizing that the country must solve the problem of our relative decline in industrial productivity if America is to regain its former position of superiority in world trade, or even in domestic markets. It is encouraging that certain segments of organized labor have recognized the problem and appear to be considering modifications of labor agreements that will help their respective industries compete more effectively.

During this trying economic period, Santa Fe is planning to continue reasonable long-range capital expenditure and other programs so that we will be in a position to benefit fully from the resumption of a more normal business level. For 1982, we have planned a capital expenditure program of $593 million, the greatest portion of which is about evenly divided between Railway and petroleum activities. The degree to which such a program is actually carried out is, of course, dependent in part on economic conditions in 1982.

Santa Fe companies will benefit from the enactment of The Economic Recovery Tax Act of 1981. Many of the Act's provisions will reduce Santa Fe's federal income tax liability and improve its cash flow in 1982 and subsequent years. The most significant feature of the law from our standpoint is a Treasury Department proposal to change the railroad's traditional retirement-replacement-betterment method of depreciating its track structure for tax purposes to the new Accelerated Cost Recovery System, which is a ratable depreciation method applicable to industry in general.

Although the railroad industry initially opposed the change because of adverse impacts on cash flow, it withdrew these objections when Treasury agreed to certain transitional rules to compensate for the short- and long-term negative impacts of the change. Thus, during a five-year period beginning in 1981, the new rules will provide additional tax deductions for the track accounts, over those which would have been available under the old RRB method. The principal source of this benefit is a provision allowing the rapid depreciation of the unrecovered cost of the track structure, as of December 31, 1980. Under the RRB method, this cost could not be deducted until the track was permanently retired from service. This change in depreciation of track will produce additional tax deductions in 1981 amounting to $208.3 million. It should be recognized, however, that in the long run, this new track provision will probably result in accelerating tax payments.

A decision is expected during 1982 on the proposed consolidation of the Missouri Pacific, Union Pacific and Western Pacific. In the hearings before the Interstate Commerce Commission, we expressed concern about possible damage to Santa Fe's market positions that could result from this merger, especially coupled with the recent extension of the Southern Pacific into Kansas City, referred to in last year's report. We will continue to appraise the emerging structure of the nation's railroad system, seeking solutions which will be in the long-term best interests of our stockholders.

Prentis C. Hale, Chairman of the Executive Committee of Carter Hawley Hale Stores, Inc., and a Santa Fe Director for 16 years, is retiring from our Board effective April 27, 1982, the date of our Annual Meeting. His thoughtful insights and valuable contributions to the management of the Company will be greatly missed.

Richard J. Flamson III, Chairman of the Board and Chief Executive Officer of Security Pacific Corporation and Security Pacific National Bank, Los Angeles, California, has been nominated as a director, and will stand for election at the Annual Meeting.

On behalf of the Directors, we wish to thank our stockholders, customers, and suppliers for their loyal support and to express our appreciation to the officers and employees for their dedication and performance.

February 24, 1982

Chairman and Chief Executive Officer

President

Santa Fe Railway's 1981 traffic levels reflected the recession that adversely affected almost every industry in the country, although major increases in coal and piggyback traffic ran counter to the trend. Despite poor economic conditions, the pre-tax contribution from rail operations of $110.4 million was the third highest in our history. Productivity was improved in several areas relating to train, station and yard operations. We continued our program of maintaining the railroad in excellent condition so that when the economy recovers we will be in position to handle further increases in business.

"Locomotives, cars, and facilities—all are in excellent shape. We're ready for the next round of growth."

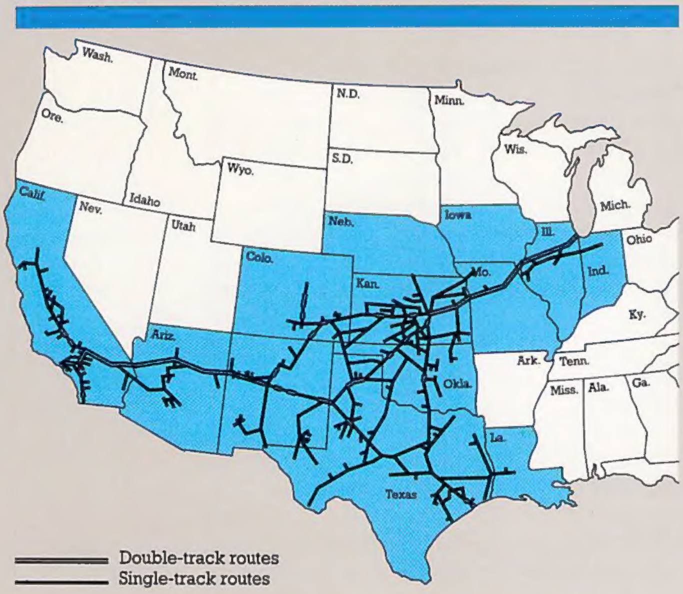
Lawrence Cena, President
The Atchison, Topeka and Santa Fe Railway Company

- Carloadings were 1.7 million, down 5% from 1980.
- Coal shipments were up 26% to 26.8 million tons.
- Piggyback traffic grew 11%.
- Capital expenditures were $280.3 million.
- 432 new freight cars and 83 new locomotives were acquired; 706 freight cars and 123 locomotives were remanufactured.
- The company laid 227 miles of new and 120 miles of reconditioned continuous welded rail and inserted 1.7 million new ties.
- The Railway has been authorized to spend $271 million on capital improvements in 1982.

Rail

	1981	1980	1979	1978	1977
Contribution to consolidated pre-tax income (millions)	$110.4	$193.9	$124.9	$100.0	$ 61.4
Capital expenditures (millions)	$280.3	$316.8	$311.2	$191.3	$168.4
Carloads handled (thousands)	1,733	1,826	1,765	1,650	1,562
Operating ratio	93.4%	89.5%	91.2%	90.9%	92.9%
Revenue ton miles (billions)	75.2	73.4	72.7	66.2	58.9
Average haul per ton (miles)	642	616	666	678	655
Track miles of rail laid	424	575	602	423	471
Ties inserted (thousands)	1,670	1,885	1,680	1,851	1,703
Freight cars	65,833	68,220	68,132	67,717	68,197
Locomotives	1,991	1,940	1,870	1,748	1,677
Trailers	9,540	9,739	8,115	7,298	5,842

Santa Fe Railway Network



Pipeline

America's farmers require a ready supply of fertilizer to meet world food demands, and increased exploration activity is creating new supplies of natural gas liquids. Our pipeline systems are uniquely situated to meet the transportation needs associated with these demands.

- "The industries we serve are growing, and we're growing with them."

  Raymond J. Hunt, President
  Santa Fe Pipelines, Inc.

- Pre-tax contribution rose 32% to $23.9 million.

- Throughput on Chaparral Pipeline increased 13%.

- Gulf Central Pipeline delivered a record 1.6 million tons of anhydrous ammonia, up 4%.

- Space leased in company terminals for storage of anhydrous ammonia increased about 9%.

Pipeline

	1981	1980	1979	1978	1977
Contribution to consolidated pre-tax income (millions)	$23.9	$18.1	$11.7	$10.0	$11.9
Capital expenditures (millions)	$ 1.3	$ 2.0	$ 3.2	$ 5.5	$20.8
Natural gas liquids transported daily (thousand barrels)	120.7	107.1	78.5	64.6	61.2
Anhydrous ammonia transported annually (thousand tons)	1,587.8	1,530.3	1,193.7	1,048.0	1,208.0

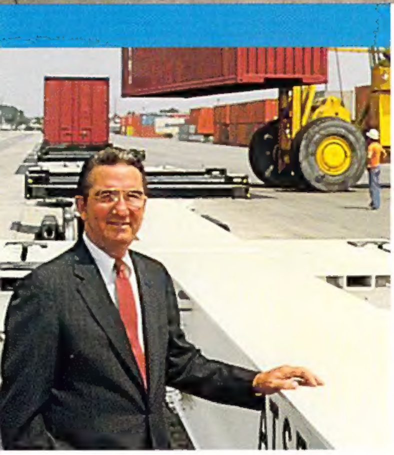
Truck

Decreased regulations and a stagnant economy combined to increase competition and reduce profitability for many trucking companies. Despite these conditions, Santa Fe Trail Transportation Company produced a profit after two years of negative pre-tax contributions.

- "Santa Fe Trail Transportation Company can now serve virtually any community in 18 states."

  C. J. Nassimbene, President
  The Santa Fe Trail Transportation Company

- Pre-tax contribution was $1.7 million.



Lawrence Cena, President
The Atchison, Topeka and Santa Fe Railway Company

Santa Fe's lightweight experimental car for containers (bottom) incorporates the basic design features of our successful "Fuel Foiler" equipment for trailers (top). It can be loaded either by overhead crane or sideloading device.

Our record of steady growth in pre-tax contribution from rail operations, which had quadrupled in the previous four years, was interrupted in 1981 by the nation's recession.

The year was not without progress, however, as productivity was improved in several areas. In addition, after excluding the dramatic growth of coal traffic on our railroad and others, we enjoyed a small increase in market share of intercity rail traffic, both nationally and in the Western District we serve. These important gains should pay future dividends, but they could not offset the combination of a stagnant economy and the growth in competitive pressures. Despite those problems, the pre-tax contribution of $110.4 million was the third highest in our history.

The nation's reduced economic activity was clearly reflected in our carloadings, which were down 5%. Reductions occurred in virtually every type of traffic we handle except piggyback, which was up about 11%, and coal, which became our volume leader with a 26% increase. The biggest disappointment was grain, which has traditionally been our largest traffic segment, where the decrease of 16% resulted primarily from declining exports.

We have continued to maintain the railroad so that it can handle anticipated traffic loads efficiently, and have adjusted our purchases of locomotives and cars to reflect demand. We are poised and ready to handle the traffic growth expected in an expanding economy.

Coal Traffic

One area where growth should continue is coal traffic. Southwestern coal has become an increasingly viable alternative for use in manufacturing, processing and electrical generating industries as oil and natural gas have increased in cost.

At year-end we were employing as many as 59 sets of equipment to provide unit coal train service for 19 separate movements. Total coal shipments reached a record 26.8 million tons, accounting for 23% of our total freight tonnage. Ten years earlier coal accounted for only 5% of our tonnage. We

expect to be handling about 31 million tons annually by 1985.

Two new mines located along our line commenced commercial operations during the year, and we expect to begin serving at least one new generating station in 1982. Initial requirements for this plant are about one million tons a year, building to a maximum of 3.4 million tons by the fifth year of operation.

Nearly all of our coal shipments have been for domestic consumption, but coal from our territory is beginning to penetrate the Far Eastern market. We expect to ship approximately one-half million tons through southern California ports in 1982, with continued growth in future years.

Another source of future growth is coal from the San Juan Basin in northwest New Mexico, which has several billion tons of virtually untapped coal reserves. In March 1981, the Interstate Commerce Commission granted us authority to construct the proposed Star Lake Railroad, which will extend northward from a point on our main line about 40 miles east of Gallup, N.M. The Commission's order, however, is subject to a court challenge. Work on the initial segment is expected to begin in mid-1982, with first shipments anticipated for early 1984 from the Lee Ranch mine, to be operated by Santa Fe Mining, Inc.

Piggyback

Our 11% increase in piggyback traffic resulted from growing acceptance of our marketing programs, especially for shipment of perishables, a widened recognition by trucking companies of the advantages to them from using economical rail service for the line haul, and deregulation.

Piggyback shipments of perishables showed a dramatic increase of 135%, reaching over 28,000 trailerloads. At year-end there were over 4,000 shipper-owned trailers dedicated to this service on our railroad, and that number continues to grow. We anticipate handling about 40,000 trailerloads of perishables in 1982.

Historically, private truckers have been reluctant to join with railroads in piggyback service. The harsh realities of fuel costs, however, have caused them to reconsider,

This unit train near Houston, Texas, carrying nearly 1,000 lengths of pipe, demonstrates Santa Fe's ability to move a wide variety of special products.

and we currently have contracts with numerous trucking firms to handle the line-haul portion of their business. Since long-haul rail service is two to three times as energy efficient as over-the-road truck service, this trend by truckers to cooperate with railroads is expected to show continued growth.

Since piggyback traffic was freed from regulation by the Interstate Commerce Commission effective March 23, 1981, rail carriers have been free to publish rates and tailor service based on demand. This has resulted in severe competition among rail carriers, as well as between the rail and trucking industries.

This intensive competition has been reflected in the pricing structure for intermodal service and it is a continuing challenge to keep expenses in line with lower unit prices. We have approached that problem by improving productivity in two important ways. As recently as 1979, Santa Fe's percentage of empty trailer backhauls was 61%, due primarily to the fact that the great majority of our piggyback business had been westbound. The dramatic response to our efforts to attract perishable traffic, plus some new marketing arrangements worked out with trucking companies, has resulted in the empty backhaul ratio being reduced to 22% in 1981.

We are now operating our energy efficient "Fuel Foiler" trains daily on the high-volume piggyback corridor between Chicago and Los Angeles. These trains are 15% more fuel efficient than conventional equipment, and conserve about 6,000 gallons of fuel on each round trip. During 1981 we converted one "Fuel Foiler" car to handle containers, and that car has performed satisfactorily in test service. Looking ahead, we are working on a new aerodynamically designed container that could further increase efficiency.

Grain

Our biggest disappointment during 1981 was the 16% decrease experienced in grain traffic, which historically has been our volume leader. The wheat harvest of 754 million bushels in our territory fell short of the record 863 million bushels in 1980, but it was

The Oklahoma Gas and Electric Company's Sooner Generating Station at Red Rock, Oklahoma, is one of those served by Santa Fe unit coal trains.

still an excellent harvest. The primary reason for the decrease in grain shipments was a reduction in sales of American grain overseas. Also affecting the comparison was a major repositioning of corn into Texas that occurred in 1980, with no comparable move during 1981. There are numerous indications that export wheat traffic may increase during 1982, although such shipments are subject to the vagaries of international political developments.

Productivity Improvements

A key barometer of railroad efficiency is the amount of gross ton miles produced per man-hour worked. That statistic for Santa Fe improved from 2,471 gross ton miles per man-hour in 1980 to 2,546 in 1981. We took several steps during the year that should result in continuing productivity improvements.

Effective May 15, 1981, an agreement was reached which will eventually result in reduction of one employee on each train and yard crew. This reduction is being implemented on an attrition basis, with savings being shared with those remaining employees who were in train service when the agreement was reached. This had minimal impact during 1981, but savings to be experienced in the future will be substantial.

We also increased efficiency during the year by replacing 45 small stations with 19 Regional Freight Offices. These new offices have direct access to a central computer, and thus can provide prompt billing services as well as accurate information relating to car movements, location, supply and other data. The program is continuing, and in 1982 we hope to replace 150 additional stations with 53 Regional Freight Offices.

Progress continued in implementation of our PLUS computer system, which incorporates the best features of our existing management programs and those employed by other railroads. PLUS will help line managers make operating decisions relating to train operations and improve the timely flow of data to our central computer system. That portion of the program designed to improve billing procedures and enhance our ability to manage yard operations will

Santa Fe took delivery of 83 diesel locomotives in 1981, bringing total ownership to nearly 2,000 units.

become fully operational in 1982. Expedited billing functions incorporated in the system will enable us to improve cash flow and profitability.

Capital Expenditures

Capital expenditures of $280.3 million were down $36.5 million from 1980, and included the acquisition of 432 new freight cars and 83 new locomotives. Another 706 freight cars and 123 locomotives were remanufactured in company shops. The roadway was maintained to high standards with installation of 227 miles of new and 120 miles of reconditioned welded rail and 1.7 million new ties.

The program for 1982, which may be adjusted as traffic volumes dictate, anticipates capital expenditures of $271 million. Major items include 55 new locomotives and 75 freight cars, plus the remanufacturing of 125 locomotives and 868 cars. Planned renewal programs anticipate laying 132 miles of new and 232 miles of reconditioned welded rail and the insertion of 1.8 million new ties.

Deregulation

Experience under the Staggers Act of 1980 has been generally satisfactory, and we are optimistic that implementation of the substantial deregulation called for will enable railroads to improve their competitive and financial positions. Under the Act's provisions, the ICC has determined that adequate revenues for railroads would be those that produce a return on investment equal to the current cost of capital. The ICC also revised regulations on market dominance, and will now permit railroads to establish effective intramodal, intermodal, product or geographic competition. The ICC has no rate jurisdiction where effective competition is present. Railroads also may recover inflation-based cost increases without challenge and with a minimum of delay. Under prior law, regulatory lag deprived railroads of millions of dollars in freight revenues.

The Staggers Act also allows railroads to enter into contracts. We are making increased use of that ability to offer a package of service and price developed to meet specific needs of individual shippers.

Over 800 complaints were filed with the ICC as a result of a provision of the Staggers Act which gave shippers an opportunity to challenge the reasonableness of existing rates before they become subject to the new cost-recovery increases. About 10% of these complaints involve Santa Fe. This large number was not anticipated, but we do not expect any wholesale upsetting of the existing rate structure.

Outlook

A study released during 1981 by an independent research firm predicted that railroad revenue ton-miles would increase 35% from 1980 to 1990. This optimistic outlook is consistent with internal studies which anticipate a dramatic growth in business and industry throughout the territory we serve.

Our program of maintaining plant and roadbed in excellent condition, keeping an adequate supply of locomotives and cars, and providing top-quality service should enable us to capitalize fully on this growth potential.

Maintenance of way employees get an early start installing continuous welded rail in Illinois.

Rail Traffic by Commodities

In billions of revenue ton-miles	1981	1980	Percent Change
Merchandise	13.0	11.8	10.2
Coal	9.5	7.6	25.0
Grain	9.3	10.9	(14.7)
Food Products	8.9	9.4	(5.3)
Chemicals	8.7	9.5	(8.4)
Non-Metallic Minerals	3.9	4.2	(7.1)
Metal Products	3.3	3.0	10.0
Petroleum Products	3.1	3.1	
Farm Products	2.9	2.5	16.0
Paper Products	2.4	2.5	(4.0)
Building Materials	1.8	2.0	(10.0)
Forest Products	1.5	1.8	(16.7)
Vehicles and Parts	1.4	1.4	
All Other	5.5	3.7	48.6
Total	75.2	73.4	2.5

The pre-tax contribution from pipeline operations rose 32% to $23.9 million in 1981, as volume and revenue of all pipeline systems reached new highs. Petroleum companies continue to identify new natural gas reserves in the territory we serve, which enhances the likelihood that the products we transport will remain in good supply, as they are derived from natural gas.

Chaparral Pipeline, which transports natural gas liquids from west Texas and New Mexico to the Houston area for use in petrochemical manufacturing and other markets, increased volume 13% to 120,700 barrels per day. Although the petrochemical industry is suffering from the recession, the strategic location of our line has enabled us to operate near capacity. Increased natural gas production and demand for liquids have attracted additional competition in the form of two new pipelines, which became operational late in 1981. This has produced excess pipeline capacity, which may temporarily affect our volume, but we anticipate that we will maintain our earnings level from Chaparral's operations.

The fertilizer industry set a new record last year, with a 6% increase in nitrogen usage. Gulf Central Pipeline, which transports anhydrous ammonia fertilizer from the Gulf Coast to Corn Belt states, shared in this growth, handling a record 1.6 million tons, a 4% improvement. Since ammonia is produced from natural gas, the new reserves being identified should ensure ample feedstock for the manufacturers we serve.

The ammonia market is not expected to grow appreciably, and we anticipate that Gulf Central's 1982 throughput will approximate that of last year. We are working on plans to increase market share in the territory we now serve, and are investigating the possibility of expanding into new markets, possibly in an arrangement that would combine our line haul with barge service to areas beyond the range of our pipeline.

Since our major pipelines are maturing, increased management attention is being given to strategic planning so that we can identify new opportunities in related fields that may prove attractive.

Raymond J. Hunt, President
Santa Fe Pipelines, Inc.

These anhydrous ammonia storage tanks at Marshalltown, Iowa, are among 17 owned and 36 served by Gulf Central Pipeline.

It is always difficult for trucking companies to improve profitability during a recession. In 1981, that problem was compounded by growth in competition resulting from decreased regulation. Most of the nation's trucking firms reported lower earnings, and many filed for bankruptcy.

The Santa Fe Trail Transportation Company was not immune to these problems, but overcame them and generated a pre-tax contribution of $1.7 million, compared with a negative contribution of $1.0 million in 1980.

Historically, with minor exceptions, the company has been limited to serving only that area served by Santa Fe Railway. That problem has been alleviated under regulatory conditions growing out of the Motor Carrier Act of 1980. The company now has authority to operate over virtually any highway in 18 midwestern and southwestern states. Consequently, SFTT concentrated its energies on profitable operations, curtailed unprofitable functions, and closed marginal terminals.

One result of these drastic changes was a sharp reduction of revenues. Expenses declined even more, however, and since May revenues and the profit margin have gradually increased.

The company can now compete on a more equal basis with other trucking companies and has several new marketing approaches, which include cooperation with owner-operators to haul low-rated commodities at a profit. Contract arrangements with shippers are being negotiated. New piggyback agreements with railroads which serve territory not reached by Santa Fe Railway have extended the areas where the trucking company can take advantage of economical rail service for the line haul. Incentive rates are being offered where backhaul space is available. Less-than-truckload freight is being vigorously solicited in corridors where that business is profitable.

Charles J. Nassimbene, President
The Santa Fe Trail
Transportation Company

Santa Fe's fleet of 613 tractors serves customers in 18 states.

The world-wide surplus of oil that prevailed during 1981 had a dampening effect on crude oil prices. This surplus is not expected to disappear quickly, but prices should strengthen during the 1980s as inventories are drawn down, incremental savings from conservation become more difficult to achieve, and world demand increases. Higher prices should result in new incentives for domestic exploration and development, and Santa Fe is planning now to capitalize on this opportunity. Our overall production in equivalent barrels increased 5% during the year.

"We're managing our operations for steady growth over the long term."

Thomas M. Orth,
Chief Executive Officer
Santa Fe Energy Company

Pre-tax contribution from petroleum production was $123.8 million.

Crude oil production was up 2%, averaging 42,900 barrels a day.

Average price per barrel increased to $27.94.

Natural gas production increased 22%.

Capital expenditures were $248.6 million, an increase of 83%.

Interests in nine offshore leases were acquired during 1981.

Current petroleum reserves, including both oil and gas, are 168.1 million equivalent barrels.

	1980	1979	1978	1977
Contribution to consolidated pre-tax income (millions)	$146.5	$ 95.9	$43.0	$63.0
Capital expenditures (millions)				
Exploratory	$ 39.4	$ 37.8	$20.4	$24.4
Development and other	$ 96.8	$ 60.5	$42.0	$98.6
Exploratory expenses (millions)	$ 38.4	$ 21.2	$28.8	$17.9
Crude oil production (thousand barrels per day)	41.8	45.1	45.8	48.5
Average price per barrel	$21.80	$11.76	$7.96	$7.61
Natural gas production (million cubic feet per day)	33.0	32.9	29.9	32.2
Average price per thousand cubic feet	$ 1.69	$ 1.29	$ .95	$ .78
Proved reserves				
Crude oil (million barrels)	141.6	137.4	130.5	139.9
Natural gas (billion cubic feet)	170.1	161.0	135.8	133.4
Net wells drilled				
Exploratory	21.5	13.1	14.9	9.9
Development	142.2	102.0	138.6	153.6

Our nation has recognized the need to decrease reliance on imported materials ranging from fuel to strategic minerals. Santa Fe Mining responded to that need in 1981 by strengthening its highly qualified exploration group, adding significantly to its coal reserve base, acquiring additional uranium properties, and conducting exploration programs for many minerals. These activities will provide a base for an ongoing development program and future growth. We are negotiating coal sales to domestic customers and investigating the foreign market.

"Our long-range exploration and development programs are designed to pay off over a period of decades."

Richard T. Zitting, President
Santa Fe Mining, Inc.

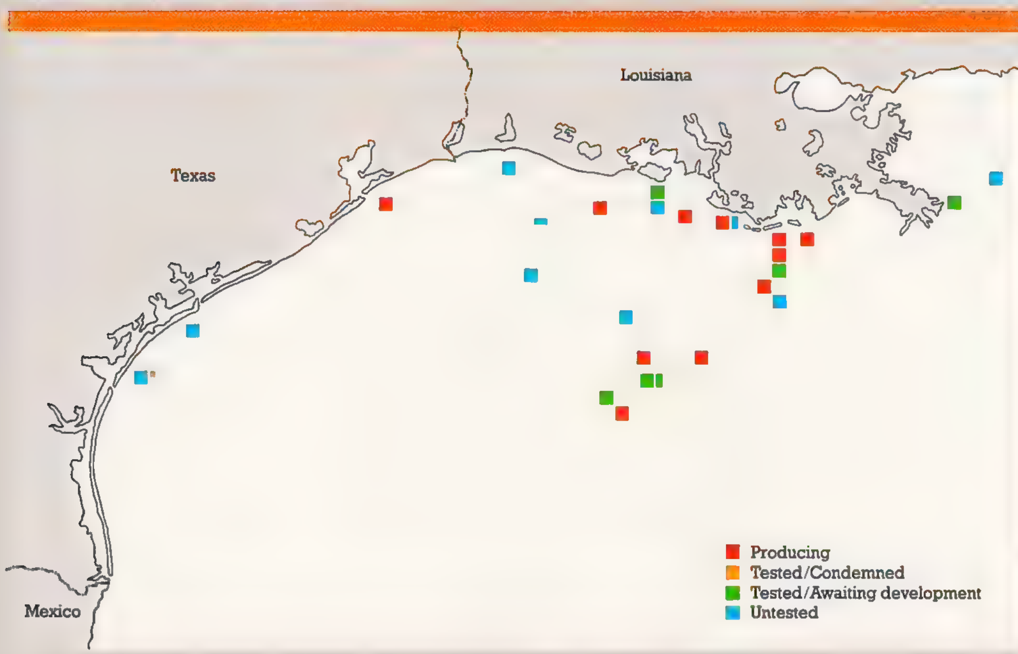
Coal royalties of $9.2 million were up 35%.

Pre-tax contribution from hard minerals was $9.0 million.

A surface mining permit has been secured for the Lee Ranch coal mine, which could commence production in 1984.

Capital expenditures were up 24% to $7.5 million.

Unleased coal reserves increased to 301 million tons, up 159% from 1980.



The supply of crude oil continued to exceed demand in 1981, adversely affecting prices on the world market. Future prices will be greatly influenced by decisions of the OPEC countries with respect to their production. It is difficult to predict with precision when the oversupply will disappear, but it is generally expected that will occur sometime during the 1980s. When that happens, those domestic producers with good reserves and substantial lease holdings will have an advantage. Santa Fe Energy is preparing now for this opportunity.

A capital expenditure program of $261 million has been approved for oil and gas operations in 1982, an increase of 5% over 1981. Plans include an expenditure of $71 million for exploration, and $190 million for development and other purposes. However, such programs will depend somewhat on the economic conditions.

We plan to engage primarily in domestic exploration at diversified locations, with allocation of funds based on continuing analysis of each area's potential. Wildcat drilling is expected to continue at a high level, as a result of aggressive land management and our improved capability to generate prospects.

As we pursue these plans, negative factors will include the industry-wide shortage of qualified specialists, severe competition for unleased acreage, and costs that are accelerating faster than the general rate of inflation.

Exploration expenditures were a record $166.4 million in 1981.

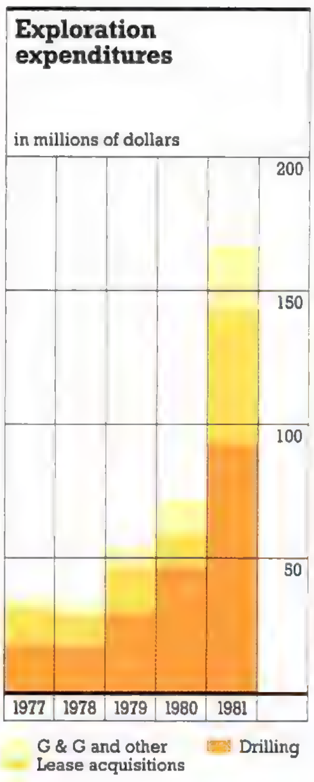
Leasing

During 1981 over $32.7 million was spent on offshore leases to acquire an interest in nine blocks, comprising 36,194 gross acres, located offshore California and in the Gulf of Mexico offshore Louisiana. Santa Fe Energy's ownership interest amounts to 9,360 net acres.

Since entering the oil and gas play in the Gulf of Mexico in 1974, we have purchased interests in 51 blocks. As indicated in the map on page 15, commercial reserves have been established on 16 of these blocks. In California, where we have acquired four

Thomas M. Orth,
Chief Executive Officer
Santa Fe Energy Company

Production began in October 1981, from this drilling platform on Vermilion Block 397, located 120 miles south of Port Arthur, Texas. (two views)



offshore blocks to date, two have commercial reserves and two are yet to be tested.

At year-end, Santa Fe Energy held undeveloped domestic oil and gas leases on 1.8 million net acres. In addition, affiliate companies own more than 3.5 million mineral acres, which may be available for lease to Santa Fe Energy as specific acreage is determined to have potential for oil and gas.

Exploratory Drilling

We continued to expand exploratory drilling during the past year, when the company participated in drilling 63 gross exploratory wells and 35.4 net wells. This activity resulted in 15 gross and 6.4 net producing wells, while 31 gross and 11.2 net wells are still being actively drilled.

We made several discoveries of both oil and gas in widely diversified areas during 1981, including offshore Louisiana; the Austin Chalk play in Burleson County, Texas; two areas of Wyoming; and the Anadarko Basin of Oklahoma. Our interests in these discoveries vary from 2% to 100%.

Other Exploration Activities

The Springer Trend in the Anadarko Basin of Oklahoma is generally regarded as one of the most promising exploration areas in the United States, primarily for natural gas. We hold oil and gas leases on about 33,000 net acres in this area, and are currently participating in a total of 46 wells there which are being drilled or are producing. Activity in this major industry exploration play should be heavy for several years.

As part of our 1982 exploratory program, we will join with our partners in test drilling on two blocks offshore California that were acquired in 1981 lease sales, and in ten exploratory wells in the Gulf of Mexico. We are currently evaluating offshore blocks scheduled to be offered in seven lease sales by the Department of Interior in 1982, and expect to participate on a selective basis.

Production

Oil production increased 2% to 15.6 million barrels, and production of natural gas rose 22% to 14.7 billion cubic feet. Overall production in equivalent barrels increased 5%.

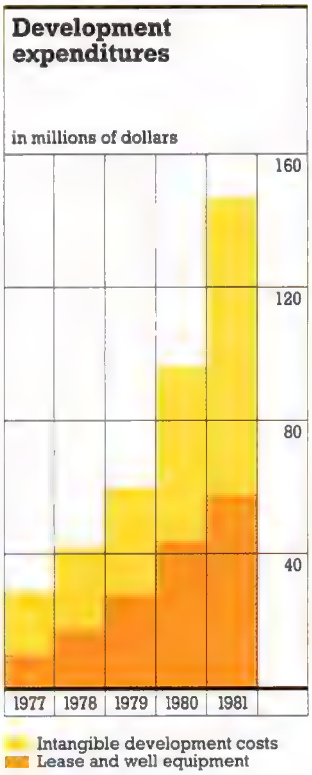
Historically our production of natural gas has been relatively minor compared to crude oil, but that is quickly changing. New discoveries in the mid-continent and the Gulf of Mexico are large gas producers, and we anticipate that natural gas production will increase significantly in 1982.

A substantial lead time is required to acquire leases, explore and develop properties. For example, we acquired a 40% working interest in Vermilion Block 397 offshore Louisiana in July 1975. Following exploratory drilling, a discovery was made in February 1977. A drilling platform was installed, and the site came on stream in October 1981, with a stabilized flow rate of 24 million cubic feet of gas plus 600 barrels of condensate per day from four completions. Four more wells should come on stream from this tract in early 1982, and additional drilling should again expand production in 1983.

Oil and Gas Prices

In January 1981, government controls on crude oil prices were eliminated, prompting many predictions that the prevalent upward trend in prices would accelerate. Within a few months, however, prices responded to market conditions, and at year-end were below the 1981 high. For the year as a whole, the rate of increase was considerably less than experienced in recent years. As shown in the table on page 14, our average price per barrel of crude oil increased 28% during the year, and natural gas prices were up 42%.

The Windfall Profit Tax continued to have a substantial effect on results, amounting to $81.4 million in 1981. Present law calls for this tax to be phased out no later than September 1993. Some relief is provided by the Economic Recovery Tax Act which decreases the tax on new oil from 30% to 15% over a period of five years beginning in 1982. The Act provides further relief for independent producers such as Santa Fe Energy by eliminating the tax on stripper wells beginning January 1, 1983. A stripper well is defined as having average production of 10 barrels or less a day for any consecutive twelve-month period after 1972. Approximately 37% of our current oil production comes from stripper wells.



Price controls on some categories of natural gas are currently scheduled to be gradually phased out by 1985. There is a possibility that we may gain earlier relief from the financial burden resulting from these controls, as the Administration has recognized the merits in accelerating decontrol. Should this occur, there are indications that a new Windfall Profit Tax might be levied on natural gas production, which would offset some of the potential benefit.

Santa Fe Energy Products Company continued to expand its role as our marketing arm, and at year-end was responsible for handling the sale of 83% of our crude oil and all of our natural gas.

Development

Development expenditures of $147.3 million for petroleum operations in 1981 were at a record level.

We participated in the drilling of 302 gross and 169.2 net development wells in 1981, of which 259 gross and 145 net were successful. At year-end we were actively drilling 116 gross and 49 net wells.

We continued to enhance production and reserves on our heavy oil properties with an aggressive secondary recovery program, primarily in the San Joaquin Valley of California. One example going on-stream in 1981 is a project at the Midway-Sunset field, which includes ten air-injection wells and 42 producing wells on a 33-acre site.

Heavy oil deposits characteristically contain a large amount of oil, but only a small fraction can be produced by primary recovery techniques. By utilizing current enhanced production techniques, we are able to recover about 50% of existing crude from our heavy oil deposits. Production technology is continuing to develop and improve, however, and as this occurs we anticipate that we will be able to increase the recovery factor and our proven reserves.

The necessity to use such procedures for heavy oil production results in equipment and operating costs that are generally high compared with conventional onshore operations. Prices for heavy crude are discounted because of specific gravity and sulfur content. As an offset to these negative factors,

(Facing page)
This Santa Fe drill rig is working in the Reeves Field in western Texas.

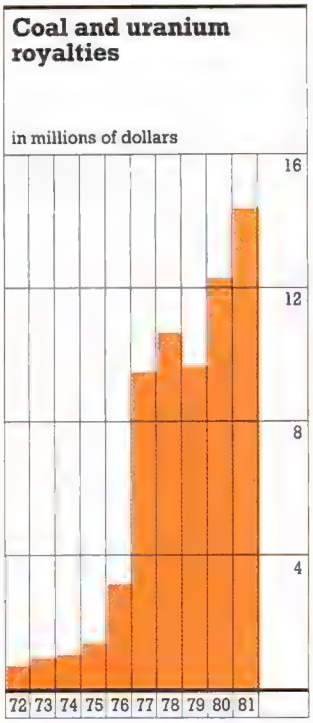
We hold oil and gas leases on about 33,000 net acres in the Anadarko Basin of Oklahoma, where this rig was conducting exploratory drilling.

drilling costs associated with heavy crude are relatively low, since these formations are usually found at shallow depths.

In addition to other steam-drive projects, construction was completed on a major fire-flood program, which will be one of the largest in situ combustion projects in the nation when it begins operations in early 1982.

Since we have been involved with heavy oil for more than 80 years and it represents about 57% of our production, we have assembled a staff with outstanding expertise in this field. We continue to adjust our techniques and utilize new methods to ensure that we remain on the leading edge of recovery technology.

This steam-drive installation plays an important role in our secondary recovery program at the Midway-Sunset field in California.



During 1981 our proved reserves of coal grew 32% to 827 million tons.

Richard T. Zitting, President
Santa Fe Mining, Inc.

As America worked to decrease dependence on imported petroleum, it became clear that a major portion of the solution lay in taking advantage of the energy sources this country has in abundance—coal and uranium.

Consumers in Europe and the Far East who share our concerns about energy are also turning to American coal.

Santa Fe's hard minerals group, with a solid base of proved coal and uranium reserves, an ongoing exploration and development program, and a cadre of highly qualified mining experts, has aggressive plans to help alleviate both domestic and foreign energy shortages.

Coal and uranium are the top priorities for Santa Fe Mining, Inc., but exploration is also under way for precious metals, base metals and other minerals.

Coal and uranium royalties reached a record \$14.3 million in 1981, compared with \$12.3 million in 1980. The pre-tax contribution of \$9 million was 4% below the previous year, due to an expanded exploration program and expenses associated with start-up of new projects. Coal royalties should continue to grow substantially, as a result of leases executed several years ago. The hard minerals group plans to utilize this income base to locate and develop new projects that will add to growth in earnings and cash flow.

The project furthest along is the Lee Ranch coal mine in northwest New Mexico. Continued drilling and a closer engineering evaluation of that location have more than doubled confirmed strippable coal reserves to 244 million tons. This project will be the first in recent history where the company does the mining, rather than lease reserves to others. A surface mining permit has been secured, engineering is proceeding, and sales are being negotiated. Deliveries could commence in early 1984. Production at Lee Ranch could reach 8 to 10 million tons per year, as markets permit.

During the year we confirmed 57.1 million tons of demonstrated reserves at a nearby location called Divide. We have leased state-owned property within Lee Ranch and in the Divide area which has the potential for increasing reserves in both

areas. Drilling continues in these and other areas, primarily in New Mexico, to expand our base of leased and unleased coal, which grew 32% to 827 million tons in 1981.

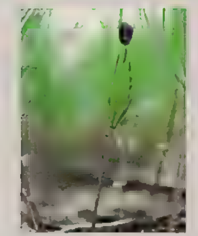
Prospects are good for future coal sales, as transportation into the San Juan Basin becomes available. Within ten years utilities in our marketing area expect to nearly double coal consumption to about 45 million tons annually. Industrial consumers in the area anticipate demand of about 5 million tons per year in that time frame. Far Eastern countries have indicated that by then they will be importing about 115 million tons per year, with up to 20 million tons coming from the western United States. Our Lee Ranch coal may be suitable for their needs, and we are engaged in an ongoing dialogue with potential overseas customers.

In the uranium field, market conditions govern activity. The recent slowdown by other uranium companies has provided opportunities to acquire additional properties. Development of new mines is not feasible at current prices, but our studies indicate conditions will change within the next five years, as demand develops to supply reactors presently under construction. In an area of northwest New Mexico known as West Largo, where we have a net reserve of over 7.8 million pounds of uranium, we are working with our partners on pre-project feasibility studies and environmental assessments. The project will be ready for development when market conditions are right, subject to the agreement of our partners.

Future exploration plans are not limited to New Mexico. We expect to search in many areas of the western United States as we continue efforts to expand coal and uranium reserves and locate other minerals. Such mining ventures are long-term projects. They involve several years of lead time from conception to production, and production may last well beyond 20 years. Such ventures require significant investment decisions based on long-term outlook, but the potential gains to be realized are great.

The programs now underway are calculated to provide sustained and substantial growth in the future.

This desolate area of northwest New Mexico is the site of the planned Lee Ranch coal mine, which Santa Fe Mining expects to have in production by early 1984.



1981 was a record low year for the home construction industry, resulting in reduced demand for the products of Kirby Forest Industries. During the year we trimmed expenses and consolidated operations where possible to increase productivity. We were successful in efforts to expand sale of our plywood products in the overseas market. Domestic demand for housing is currently growing faster than homes are being built, and industry forecasts indicate housing starts will increase up to 60% from current levels during the next three years.

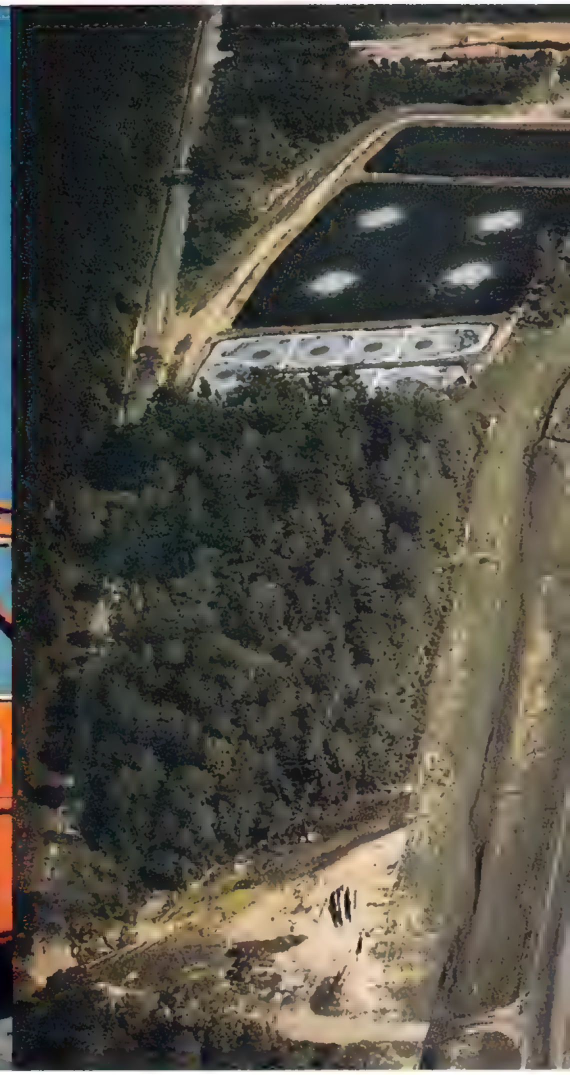
"Future opportunities will result from the accumulated backlog of demand for housing. We're getting ready now."

J. E. Stevens, President
Kirby Forest Industries, Inc.

- Plywood shipments reached 467.1 million square feet, up 15%.
- Kirby's plywood exports grew 182%, reaching 31 million square feet.
- Capital expenditures were $12.9 million.
- 23,500 acres of land were prepared for planting, an increase of 179% over 1980, and 6.5 million seedlings were planted.
- A new 400-acre nursery site was started, which will produce up to 20 million high-quality seedlings annually under controlled conditions.
- Pre-tax contribution declined to $1.2 million.

Forest Products

	1980	1979	1978	1977
Contribution to consolidated pre-tax income (millions)	$ 8.6	$15.3	$22.8	$21.9
Capital expenditures (millions)	$21.6	$53.9	$18.1	$12.3
Timberland owned in fee (thousand acres)	654.6	653.9	631.6	632.3
Plywood shipped (million square feet)	405.1	424.8	371.3	352.4
Lumber shipped (million board feet)	86.3	73.8	63.8	63.5
Seedlings planted (millions)	6.1	7.5	10.1	11.8



J. E. Stevens, President
Kirby Forest Industries, Inc.

Sales of plywood to European markets grew to 31 million square feet during 1981.

Kirby Forest Industries, Inc., reported record sales and production volume during 1981, but depressed prices in the construction industry and higher operating costs caused the pre-tax contribution from forest products operations to decline to $1.2 million from $8.6 million in 1980.

Current demographics indicate that the future should be bright for home construction in the long term. Numerous mortgage techniques were introduced by the financial community during 1981 in an effort to accommodate the growing backlog of people who wished to purchase homes, but those plans could not overcome the underlying problem of high interest rates. Consequently, housing starts fell to 1.1 million from 1.3 million in 1980. Current industry forecasts call for an increase of 60% in housing starts over the next three years, as the economy recovers, with 1982 starts predicted to reach 1.3 million. Kirby plans to participate in that anticipated growth, and has taken several steps to improve efficiency and expand marketing efforts.

Forest Management

Application of modern forestry techniques over a prolonged period has reduced the time required for a tree in Kirby forests to reach maturity from 55 years to 35 years. That development has resulted in a substantial improvement in the harvest available from our property, and dramatizes the importance of a top-quality re-forestation program.

We have been increasingly concerned about the stability of supply and quality of the seedlings available to us from outside sources, and during the year we completed the first phase of a program designed to resolve that problem. Following a selection process which included both soil and water analysis, a 400-acre site in Wood County, Texas, was acquired for use as a seedling nursery. Initial production of 16 million seedlings is planned for 1982, increasing to 20 million for 1983. There is sufficient area for higher production if required later.

Last year we prepared 23,500 acres for planting, more than double the amount of any previous year and an increase of 179% over 1980. This increase was accompanied by a

Kirby's new plywood and lumber production plant at Cleveland, Texas, which began operation in August 1980.

50% decrease in unit cost per acre, due to the acquisition of more productive and efficient equipment used for site preparation.

As an extension of the timber base we own, which covers about 655,000 acres, we now have under contract 44,000 acres owned by private landowners. Under this formal Landowners Assistance Program, Kirby provides its expertise for growing and managing timber resources to the individual tree farmers. In return, Kirby has the right of first refusal to purchase the timber when it reaches maturity.

Production

Total plywood shipments from all of our facilities of 467.1 million square feet set a new record, although weakened demand caused us to operate at less than full capacity. Lumber shipments grew 21% from 1980, and reached 104 million board feet. Particleboard shipments of 60.5 million square feet were up 17% from the previous year.

Our program to equip conversion plants with sophisticated lathe devices, which enable us to recover more useable material from each log, is nearing completion. We are planning capital expenditures of $9 million in 1982 for technological changes such as this to keep our plants among the most modern in the industry.

Marketing

At the present time we market 69% of our plywood, 98% of our lumber and 36% of our particleboard in Texas. Texas continues to show rapid population growth, and we will continue to play an important role in that dynamic market. We are also working on other plans that should result in the expansion of our market area both overseas and domestically.

During 1981 we exported 31 million square feet of plywood to foreign markets, an increase of 182%. Indications are that overseas sales will reach 50 million square feet in 1982, and more in future years. Our primary markets have been Europe and the United Kingdom. We have sold a limited amount of products in South America and to Caribbean countries, and hope to develop these markets in the future.

Domestically we are completing a study on the feasibility of establishing wholesale warehouses in new areas of the Southwest which have long-range potential. The geographic area most favorable for implementation of this strategy is the territory stretching west from Texas to California. Changing economic conditions are improving the possibility that we can compete effectively in this territory with western plywood manufacturers.

Other Developments

We are continuing to study the possibility of constructing a pulp/paper manufacturing facility at Bon Wier, Texas. If this project is developed, it will utilize residuals from existing plants, plus small pine and hardwood trees which grow on our properties but do not presently fill a need in our manufacturing processes.

Through its four modern retail outlets in Houston and three in non-metropolitan areas, Walker-Kurth Lumber Company increased sales by 21% in 1981 to $38 million, although these operations also experienced a profit pinch as a result of the depressed market. We expect our retail operations to grow along with the population in the dynamic Sun Belt.

As part of the program to improve future quality of Kirby forests, cuttings from genetically superior trees are grafted onto young stock which is then cultivated in seed orchards. (Two photos)

Real Estate

We have 22,000 acres of land with significant appreciation and investment potential, including parcels in major cities of the Southwest and West, so Santa Fe's real estate operations are well positioned for growth.

Construction

Construction continues strong in the Southwest, despite the recession. We are well structured to compete for major building contracts, such as high-rises, hospitals, industrial development and government projects.

"A substantial amount of our land is well located, and we're going to use that opportunity to the greatest advantage."

Douglas W. Hall, President
Santa Fe Realty, Inc.

Capital expenditures for real estate and construction were $12.5 million.

The pre-tax contribution from real estate and construction activities dropped to $32 million from $42.2 million in 1980, due to decreased land sales and effects of high interest rates.

"We are well established in three of the four most active commercial building areas in the country—Houston, Los Angeles and Dallas."

C. E. Turner, President
Robert E. McKee, Inc.

The incomplete portion of contracts in progress at year-end was $162.7 million.

New construction awards of $184.8 million were obtained in 1981.

	1980	1979	1978	1977
Contribution to consolidated pre-tax income (millions)	$ 42.2	$ 25.6	$ 19.4	$19.8
Capital expenditures (millions)	$ 9.1	$ 17.7	$ 10.6	$ 2.9
Property owned (thousand acres)	22.5	23.4	25.2	25.8
Industries located	361	382	382	479
Incomplete portion of construction contracts (millions)	$174.8	$184.4	$167.1	$97.2

During the year we reorganized our real estate operations into two separate activities. The responsibility for attracting industries to locate along the railroad has been shifted to Santa Fe Railway. The balance of our real estate activities has been streamlined and a new company, Santa Fe Realty, Inc., was established. This reorganization will allow us to place increasing emphasis on programs aimed at maximizing the value of our various holdings.

We currently hold 22,000 acres of investment property, most of which is undeveloped, including numerous parcels that are strategically located in major cities of the Southwest and West. In addition, there are some well-located parcels currently being used by the railroad or other subsidiaries that have significant potential. Our objective is to continue these existing business operations while initiating programs that will put the real estate to the best possible use.

An example is a 16-acre parcel in downtown San Diego, a portion of which currently is underutilized as a railroad terminal. We are actively analyzing this investment for its future potential. This will be a long-range project for which no master plan has yet been approved, but current planning envisions a combination of commercial, office and hotel development.

We are currently involved in evaluating the potential of several other key parcels in California, including locations in San Diego and Orange Counties, plus waterfront property on San Francisco Bay. As these projects evolve, our strategy will be to build on some parcels for investment purposes and enter into joint ventures on others, depending on the situation.

Planning was completed in 1981 for a project involving our company headquarters building in Chicago. A complete restoration of this landmark structure, which was designed by the noted Chicago architect Daniel Burnham, is envisioned. This project is currently in the design phase, with construction expected to be completed in about three years. Following completion, it is expected that about half the available space will be occupied by company personnel, with the balance available to other tenants.

Douglas W. Hall, President
Santa Fe Realty, Inc.

Development plans are under way for this 16-acre tract in downtown San Diego.

The $17 million Brookhollow III office complex in Houston was completed by McKee in January 1982.

Dramatic growth in construction activities continued during 1981 in the Sun Belt area served by Robert E. McKee, Inc., while construction was in the doldrums throughout much of the country.

Houston ranked first with a 50% growth for nonresidential building construction, Los Angeles was second and Dallas third. McKee is strong in all three marketing areas.

At year-end, the incomplete portion of McKee's contracts in progress was $162.7 million. New construction awards of $184.8 million were obtained, compared with $189.4 million in 1980, and $196.9 million of new construction was put in place.

While business has been generally good, construction in the Sun Belt is not completely immune to economic conditions. Several projects are pending where McKee has been selected as contractor, but no construction contract has been signed due to difficulties being experienced by owners in arranging financing. To some extent, this has created a backlog of demand that should be realized when interest rates decline.

In recent years a large percentage of McKee's work has come from projects that are put up for bid, such as government buildings, hospitals and the like. That field is still being actively pursued, but new depreciation rules for tax purposes are expected to accelerate demand for high-rise, commercial, and industrial construction in McKee's marketing area. The company has experience in those fields, has expanded and reorganized its staff of business development experts and engineers, and is planning aggressively for growth in these areas.

Much industrial and high-rise work is negotiated rather than put up for bid. To be successful under those conditions requires a high profile with architects and owners, and McKee has embarked on a marketing program to achieve that end. Its excellent reputation and record of completing contracts on time and within budget are serving it well in this endeavor. At the present time eight high-rise office buildings and seven industrial projects are under construction, and it has commitments on eight other jobs which are awaiting financing by owners.

C. E. Turner, President
Robert E. McKee, Inc.

Financial Review

Five Year Selected Financial Data

For The Year (In Millions)	1981	1980	1979	1978	1977
Revenues and Sales	$3,366.9	$3,122.8(1)	$2,555.6	$2,098.7	$1,850.4
Net Income	242.2	301.8	227.7	165.3	158.5
Capital Expenditures	563.9	494.3	489.7	295.6	334.6
Depreciation, Depletion and Amortization	184.6	145.0	124.1	122.7	108.9
Wages, Salaries and Benefits	1,346.0	1,236.3	1,119.0	959.6	876.6
At Year End (In Millions)					
Total Assets	$4,677.8	$4,330.2	$3,883.1	$3,537.8	$3,313.7
Working Capital	174.8	169.8	112.8	217.5	203.2
Long Term Debt and Capital Lease Obligations Due After One Year	746.9	783.6	709.1	712.3	726.8
Stockholders' Equity	2,471.5	2,305.5	2,064.8	1,883.4	1,774.7
Per Common Share (2)					
Net Income					
Primary	$ 2.73	$ 3.47	$ 2.69	$ 1.99	$ 1.97
Fully Diluted	2.68	3.35	2.54	1.86	1.80
Dividends Declared	1.00	.90	.82	.73	.70
Stockholders' Equity	27.73	26.21	23.99	22.47	21.49

Information on Common Stock Dividends and Price Ranges (2)

	Dividends declared per share		Price ranges			
Quarter	1981	1980	1981		1980	
			High	Low	High	Low
First	$ .25	$ .21⅔	$36⅛	$26¾	$24	$15⅞
Second	.25	.21⅔	32⅜	24½	20⅝	16½
Third	.25	.21⅔	27½	19⅞	25	18⅝
Fourth	.25	.25	24¼	20	36⅜	23¼
Year	$1.00	$ .90	$36⅛	$19⅞	$36⅜	$15⅞

Santa Fe common stock is traded on both the New York and Midwest Stock Exchanges. As of January 29, 1982, there were 82,602 holders of Santa Fe common stock.
(1) Restated to reflect the trading activities of the petroleum marketing operations on a net basis.
(2) Restated for three-for-one stock split effective May 11, 1981.

Financial Condition

A review of the consolidated balance sheet presented on pages 36 and 37, indicates that Santa Fe Industries, Inc. is in strong financial condition. In the opinion of Santa Fe management, the financial condition of the company is fully capable of supporting the current requirements and the growth planned for Santa Fe's various business groups.

It is anticipated that internally generated cash flows will be supplemented by external debt issues to finance capital expenditures and working capital requirements. In 1981 Santa Fe entered into a revolving credit agreement with a number of major banks to borrow a maximum of $150 million until May 31, 1985. Santa Fe management believes that additional external sources of funds will continue to be available due to Santa Fe's low ratio of debt to capitalization, favorable fixed charge coverage ratio and current fair value of its natural resources, forest products and real estate assets.

The enactment of the Economic Recovery Tax Act of 1981 contained several provisions which will reduce Santa Fe's federal income tax liability over the next several years and provide additional funds to meet required expenditures. The effect of this change is discussed more fully in Note 2 to the Financial Statements.

The ratio of debt to total capitalization was 22.6% at December 31, 1981, and if deferred federal income tax is considered as a part of total capitalization, the ratio would be reduced to 18.4%. Due to these extremely favorable ratios and a relatively good return on stockholders' equity of 10.1% for 1981, Santa Fe's coverage of fixed charges was 4.4 times in 1981. Because these ratios are considered to be important factors by agencies who rate new debt issues, Santa Fe management believes future debt issues will be awarded favorable ratings. These ratings have a significant impact on the interest rate and market for debt issues.

Note 10 to the Financial Statements provides information relating to the present value of estimated future net revenues from proved petroleum reserves determined in accordance with rules and regulations established by the Securities and Exchange Commission. Santa Fe continues to believe this method understates the fair value of these assets; however, the information supports a value significantly higher than the historical costs reflected in the consolidated balance sheet. In addition, the effects of inflation have substantially increased the value of Santa Fe's real estate and forest products properties over the historical costs reflected in the consolidated balance sheet. These factors, combined with the overall strong financial position of Santa Fe further supports management's belief that external borrowings would be available at acceptable terms to finance further development of its resources.

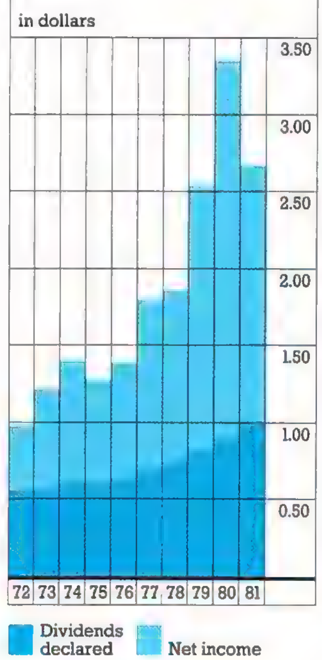
Capital expenditures were $563.9 in 1981, $494.3 in 1980 and $489.7 in 1979. A substantial portion of these expenditures were for rail equipment and roadway improvements and for oil and gas exploration and development. During the last three years, 77% of these expenditures were provided by internally generated funds, with the balance being furnished through rail equipment obligations and bank loans. Subject to possible adjustments to reflect economic conditions, Santa Fe plans capital expenditures of $593 million in 1982. Rail expenditures are expected to be $271 million, a slight decline from 1981, as Railway's present fleet of locomotives and freight cars appears adequate for handling anticipated traffic levels without a large acquisition program. Natural Resources capital expenditures are expected to increase to $272 million from the $256 million spent in 1981 and the $142 million spent in 1980.

While spending significant amounts for capital improvements, Santa Fe has paid dividends to its stockholders in the years 1979 to 1981 amounting to 32%, 27% and 37% of fully diluted earnings per share. The currently indicated annual dividend rate is $1.00 per share.

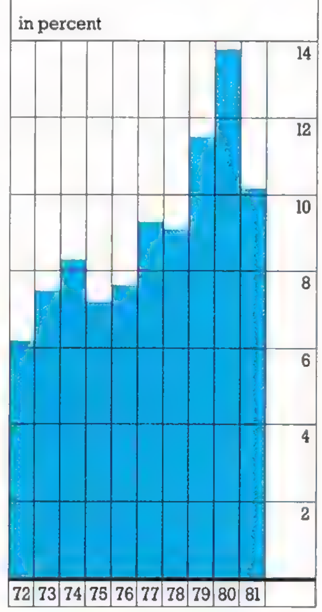
During the last three years, Santa Fe has maintained a debt to capitalization ratio of 25% or less and a working capital ratio of 1.2 to 1 or greater. Working capital has ranged between $113 million and $175 million.

Stockholders' equity at December 31, 1979, 1980 and 1981 was $23.99, $26.21 and $27.73 per share, respectively.

Dividends and net income per share

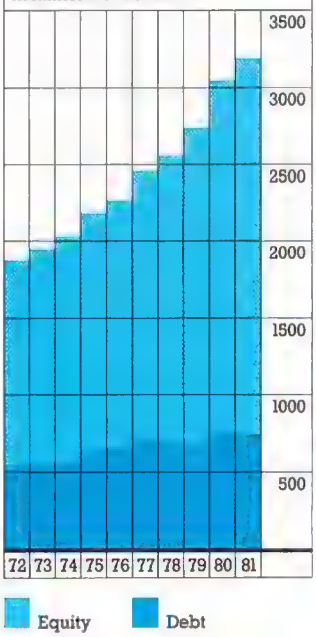


Return on stockholders' equity



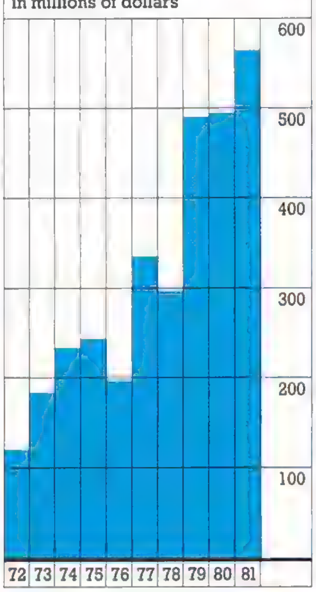
Capitalization

in millions of dollars



Capital expenditures

in millions of dollars



Results of Operations 1981 Compared with 1980

The effects of the economic recession, freight rate reductions in Railway's TOFC and grain business, increased exploratory costs, and the effect of inflation on operating costs were the primary reasons for the 20% reduction in Santa Fe net income.

The transportation group results were down due to lower results from rail operations because of a 5% decline in rail carloadings due to the economic recession and a significant drop in grain shipments, the effect of freight rate reductions on trailer-on-flat-car and grain business and an unfavorable change in commodity mix due to the economic recession. Because of these factors, rail revenues increased only $136.9 million even though general freight rate increases resulted in $257.3 million of additional revenues. Despite aggressive cost reduction programs in rail operations, large increases occurred in wage and fringe benefit costs, fuel costs and equipment rents which more than offset revenue gains. Trucking and pipeline operations both reported higher pre-tax contributions.

Higher petroleum exploration expenses and the Windfall Profit Tax being in effect for the entire year of 1981 as compared to ten months in 1980 lowered the natural resources group pre-tax contribution by 15% in 1981 compared with 1980. With the complete decontrol of crude oil prices on January 28, 1981, crude oil prices rose 28% to $27.94 in 1981. Windfall Profit Tax increased $44.1 million to $81.4 million in 1981 because of higher prices and production and the tax being in effect for the entire year. A 2% increase in oil production to 42,900 barrels per day occurred in 1981 mainly because of 1980's three month strike by production workers which held down production in 1980. In late 1981 several new gas properties were placed in production raising the average gas production by 7.4 million cubic feet per day to 40.4 million cubic feet per day with production at year end being 62.2 million cubic feet per day. Exploratory expenses, principally dry holes, rose 116% to $83 million as Santa Fe committed more funds to petroleum exploration in an effort to replace and increase reserves.

Both the forest products and real estate and construction groups suffered from high interest rates and the overall effects of the recession.

Other income-net rose 24% over 1980 reflecting higher interest income as the effect of high interest rates more than offset the lower level of investable funds.

The effective federal income tax rate declined from 29.7% in 1980 to 24.1% in 1981 due to lower pre-tax income while the aggregate investment tax credit and other reductions remained at the same level as the previous year.

1980 compared with 1979

Net income rose 33% in 1980 over the previous year reflecting record levels of contribution by the transportation, natural resources and real estate and construction groups.

The transportation group benefitted from $311 million of rail freight rate increases in 1980 and a 1% gain in rail revenue ton-miles over 1979. This improvement in revenues was partially offset by increases in operating expenses, principally in fuel prices, wage and fringe benefit costs and the effects of inflation on material costs.

The natural resources group crude oil prices rose from an average of $11.76 per barrel in 1979 to $21.80 in 1980 due largely to partial decontrol of crude oil prices. Crude oil production declined 7% to 41,800 barrels per day in 1980 reflecting normal decline in older properties as well as the effect of a three month strike by production workers in early 1980. Expenses of the natural resources segment rose 99% over 1979 due to enactment of the Windfall Profit Tax in 1980, increases in depreciation and depletion as costly new properties were brought into production, increased exploratory expenses and the effects of inflation on material and labor.

The forest products group suffered in 1980 from the effect of high mortgage rates and the recession in the housing industry.

Real estate and construction contribution reached a record high in 1980 reflecting higher land sales profits and the continued boom in commercial construction in the Sun Belt states.

Other income-net dropped 33% from 1979 as a result of lower interest income stemming from a decline in investable funds, as well as a $6 million drop in gain on purchase of outstanding Railway Bonds.

Effects of Inflation

The effects of inflation on Santa Fe are discussed in the data presented in Note 13 to Financial Statements. This data demonstrates that net income computed in accordance with historical cost measurements overstates profits because that method fails to reflect a depreciation charge based on the current cost of replacing productive capacity. However, Santa Fe does not believe that such data fully reflect the effects of inflation on the results of operations since they do not fully reflect the fair value of Santa Fe's natural resources, forest products and real estate assets due to inflation.

Report of Independent Accountants

To the Stockholders, Chairman and Board of Directors of Santa Fe Industries, Inc.

In our opinion, (a) the accompanying consolidated balance sheet and the related consolidated statements of income, of stockholders' equity and of changes in financial position present fairly the financial position of Santa Fe Industries, Inc. and subsidiary companies at December 31, 1981 and 1980, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1981, in conformity with generally accepted accounting principles consistently applied and (b) the consolidated statements of income for each of the seven years in the period ended December 31, 1978, which have been prepared from the applicable statements covered by our opinions in each of those years, present fairly the financial information included therein. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse

Chicago, Illinois
February 23, 1982

Statement of Income

	1981	1980(1)
		(In Millions)
Revenues and Sales		
Transportation	$2,472.3	$2,337.7
Natural resources	497.5	390.1
Forest products	149.9	137.0
Real estate and construction	247.2	258.0
Total revenues and sales	3,366.9	3,122.8
Operating Expenses		
Transportation	2,288.2	2,080.2
Natural resources	362.7	231.1
Forest products	146.8	127.3
Real estate and construction	214.9	215.7
Total operating expenses	3,012.6	2,654.3
Operating Income	354.3	468.5
Other Income—Net	28.6	23.0
Interest Expense	51.5	50.1
Income Before Income Taxes	331.4	441.4
Federal Income Tax		
Currently payable (refundable)	(82.1)	55.4
Deferred	159.1	71.9
State Income Tax	12.2	12.3
Total income taxes	89.2	139.6
Net Income	$ 242.2	$ 301.8
Net Income Per Share of Common Stock (2)		
Primary	$ 2.73	$ 3.47
Fully diluted	2.68	3.35
Dividends Declared Per Share of Common Stock (2)	$ 1.00	$ .90

(See notes to financial statements)

(1) Restated to reflect state income tax separately and to reflect the trading activities of the petroleum marketing operations on a net basis. Years prior to 1980 were not restated due to immateriality of amounts involved.

(2) Restated for three-for-one stock split effective May 11, 1981.

1979	1978	1977	1976	1975	1974	1973	1972
							(In Millions)
$1,981.9	$1,645.8	$1,450.1	$1,226.8	$1,101.0	$1,131.5	$1,006.9	$878.3
223.0	159.5	159.7	144.4	144.8	117.7	63.4	49.6
131.5	119.0	99.7	72.0	49.0	34.0	32.4	23.0
219.2	174.4	140.9	150.8	137.4	139.9	116.2	21.9
2,555.6	2,098.7	1,850.4	1,594.0	1,432.2	1,423.1	1,218.9	972.8
1,803.0	1,492.1	1,335.6	1,139.0	1,016.0	1,031.3	903.4	774.1
116.1	100.4	84.2	66.0	60.8	45.2	29.8	25.1
115.2	95.8	76.8	58.9	43.3	28.8	25.4	18.5
193.3	154.8	121.0	137.0	130.2	131.2	102.5	12.5
2,227.6	1,843.1	1,617.6	1,400.9	1,250.3	1,236.5	1,061.1	830.2
328.0	255.6	232.8	193.1	181.9	186.6	157.8	142.6
34.5	34.2	35.4	21.6	12.3	19.9	22.2	9.9
49.5	53.1	49.7	46.4	44.1	37.5	35.6	33.3
313.0	236.7	218.5	168.3	150.1	169.0	144.4	119.2
43.5	34.1	10.7	26.2	22.5	24.5	18.7	15.9
41.8	37.3	49.3	21.6	18.4	24.4	22.9	22.3
85.3	71.4	60.0	47.8	40.9	48.9	41.6	38.2
$ 227.7	$ 165.3	$ 158.5	$ 120.5	$ 109.2	$ 120.1	$ 102.8	$ 81.0
$ 2.69	$ 1.99	$ 1.97	$ 1.54	$ 1.41	$ 1.56	$ 1.34	$ 1.08
2.54	1.86	1.80	1.39	1.27	1.40	1.21	.98
$ .82	$ .73	$ .70	$ .63	$ .60	$ .60	$ .55	$ .55

Balance Sheet

Assets	1981	1980
		(In Millions)
Current Assets		
Cash	$ 7.5	$ 13.6
Temporary investments, at cost	64.9	170.4
Accounts receivable, less allowances	441.7	404.2
Federal income and employment taxes receivable	93.3	17.1
Inventories	193.3	164.6
Other	14.8	10.5
Total current assets	815.5	780.4
Other Assets		
Voluntary Bond Retirement Fund	29.5	49.0
Investments in affiliated companies	22.1	22.3
Funds segregated for capital expenditures	3.5	20.4
Other	72.7	62.5
Total other assets	127.8	154.2
Properties		
Transportation	3,847.7	3,678.9
Natural resources (successful efforts)	841.8	602.5
Forest products	203.7	194.3
Real estate and construction	147.5	138.9
	5,040.7	4,614.6
Accumulated depreciation, depletion and amortization	(1,327.9)	(1,244.3)
Net properties	3,712.8	3,370.3
Leased Properties Under Capital Leases	21.7	25.3
Total	$4,677.8	$4,330.2

(See notes to financial statements)

Liabilities and Stockholders' Equity	1981	1980
		(In Millions)
Current Liabilities		
Drafts payable	$ 43.4	$ 32.3
Accounts and wages payable	219.6	187.0
Accrued liabilities	302.7	258.4
Federal income tax		33.0
Dividends declared	22.3	22.0
Long term debt due within one year	52.7	77.9
Total current liabilities	640.7	610.6
Long Term Debt Due After One Year	720.8	752.9
Obligations Under Capital Leases	26.1	30.7
Other Liabilities and Deferred Credits	96.8	70.7
Deferred Federal Income Tax	721.9	559.8
Commitments and Contingencies (Note 9)		
Stockholders' Equity (see page 38)		
Capital stock	297.1	293.3
Paid-in capital	121.7	109.8
Retained income	2,055.7	1,902.4
Unamortized value of restricted stock issued under Growth Plan	(3.0)	
Total stockholders' equity	2,471.5	2,305.5
Total	$4,677.8	$4,330.2

Statement of Stockholders' Equity

	1981		1980		1979	
	Shares	Amount	Shares(1)	Amount	Shares(1)	Amount
	(In Thousands)	(In Millions)	(In Thousands)	(In Millions)	(In Thousands)	(In Millions)
Capital Stock						
$.50 Cumulative Preferred Stock						
Balance at beginning of year			792	$ 7.9	1,064	$ 10.6
Conversion into common stock			(669)	(6.7)	(272)	(2.7)
Shares redeemed			(123)	(1.2)		
Balance at end of year			—	—	792	7.9
Common Stock, $3.33⅓ par value, 150,000,000 shares authorized						
Balance at beginning of year	87,978	$ 293.3	85,743	285.8	83,340	277.8
Conversion of debentures and preferred stock	945	3.1	1,950	6.5	1,926	6.4
Issuance under Growth Plan	143	.5				
Exercise of stock options	71	.2	285	1.0	477	1.6
Balance at end of year	89,137	297.1	87,978	293.3	85,743	285.8
Total capital stock at end of year		$ 297.1		$ 293.3		$ 293.7
Paid-In Capital						
Balance at beginning of year		$ 109.8		$ 91.6		$ 71.8
Conversion of debentures and preferred stock		6.9		15.1		14.4
Issuance under Growth Plan		4.1				
Exercise of stock options		.6		2.3		3.3
Other		.3		.8		2.1
Balance at end of year		$ 121.7		$ 109.8		$ 91.6
Retained Income						
Balance at beginning of year		$1,902.4		$1,679.5		$1,523.2
Net income		242.2		301.8		227.7
Dividends declared						
Preferred stock				(.2)		(.4)
Common stock		(88.9)		(78.7)		(69.3)
Other						(1.7)
Balance at end of year		$2,055.7		$1,902.4		$1,679.5

(See notes to financial statements)
(1) Restated for three-for-one stock split effective May 11, 1981.

Statement of Changes in Financial Position

	1981	1980	1979
			(In Millions)
Working Capital Sources			
Net income	$ 242.2	$301.8	$ 227.7
Provision for deferred federal income tax	159.1	71.9	41.8
Depreciation, depletion and amortization	184.6	145.0	124.1
Other—net	22.0	17.2	22.5
Total from operations	607.9	535.9	416.1
Salvage from depreciable properties retired	25.4	17.4	26.2
Long term debt incurred	77.9	181.9	102.9
Transfer of assets from Voluntary Bond Retirement Fund	34.4		
Change in funds segregated for capital expenditures	16.9	(20.4)	3.1
Conversion of debentures and preferred stock	10.0	21.6	20.8
Exercise of stock options	.8	3.3	4.9
Total working capital sources	773.3	739.7	574.0
Working Capital Uses			
Capital expenditures			
Transportation	282.4	321.3	318.2
Natural resources	256.1	142.3	99.9
Forest products	12.9	21.6	53.9
Real estate and construction	12.5	9.1	17.7
Total capital expenditures	563.9	494.3	489.7
Dividends declared	88.9	78.9	69.7
Reduction in long term debt	110.0	103.4	108.3
Other—net	5.5	6.1	11.0
Total working capital uses	768.3	682.7	678.7
Increase (Decrease) in Working Capital	5.0	57.0	(104.7)
Working Capital at Beginning of Year	169.8	112.8	217.5
Working Capital at End of Year	$ 174.8	$169.8	$ 112.8
Changes Increasing (Decreasing) Working Capital			
Cash and temporary investments	$(111.6)	$(17.5)	$(118.2)
Accounts receivable	37.5	59.7	96.5
Federal income and employment taxes receivable	76.2	17.1	
Inventories	28.7	45.8	27.6
Drafts payable	(11.1)	19.4	(25.8)
Accounts and wages payable	(32.6)	(20.9)	(38.5)
Accrued liabilities	(44.3)	(28.0)	(26.3)
Federal income tax	33.0	(15.0)	9.6
Long term debt due within one year	25.2	(2.1)	(28.0)
Other—net	4.0	(1.5)	(1.6)
Increase (Decrease) in Working Capital	$ 5.0	$ 57.0	$(104.7)

(See notes to financial statements)

Notes to Financial Statements

Note 1: Summary of Significant Accounting Policies

Principles of Consolidation
The accompanying consolidated financial statements include the accounts of Santa Fe Industries, Inc. (Santa Fe) and all entities over 50% owned, directly or indirectly, by Santa Fe. Investments in 20% to 50% owned entities are accounted for under the equity method.

Revenue Recognition
Revenues from transportation operations are recognized in income upon completion of service. Revenues from sales of petroleum, forest products and real estate are recognized in income upon passage of title. Advance coal royalties are recognized in income in the year received.

Effective in 1981, the revenues and expenses of the trading activities of the petroleum marketing operations are presented on a net basis whereby only the gross margin from such activities is recorded as revenues. Amounts for 1980 have been restated for comparability, but years prior to 1980 have not been restated due to immateriality. For the years 1981 and 1980 gross revenues of such activities were $727.4 million and $93.6 million, respectively, and cost of sales were $723.3 million and $92.2 million, respectively.

Long Term Construction Contracts
The percentage of completion method is used to account for long term construction contracts. Under this method, revenues recorded represent the aggregate of costs incurred during the year and a portion of estimated profit on individual contracts based on the relationship of costs incurred to total estimated costs. No profit is recognized on individual contracts until at least 10% of estimated costs are incurred. Anticipated losses on contracts are charged to income in their entirety when such losses become evident.

Properties
Properties are stated substantially at cost and include capitalized interest cost incurred during construction ($22.2 million in 1981, $16.3 million in 1980 and $9.8 million in 1979).

Additions, betterments and replacements other than replacements of track structure are capitalized. Expenditures for maintenance and repairs are charged to income. Upon sale or retirement of units of depreciable railroad and pipeline properties, cost less salvage is charged to accumulated depreciation and no gain or loss is recognized. With respect to all other property units sold or retired, gain or loss is recognized.

Depreciation of Properties (other than petroleum)
Properties, other than non-depreciable properties and track structure, are depreciated on a straight-line basis over their estimated service lives. The "retirement-replacement-betterment" method is followed in accounting for track structure. This method is prescribed by the Interstate Commerce Commission (ICC) and generally represents industry practice. Under this method, the cost of replacing track structure, less salvage recovered, is charged to income and only the cost of betterments is capitalized. The amounts capitalized are not depreciated. Upon retirement of elements of track structure, the entire amount capitalized, less salvage recovered, is charged to income.

Leasehold Interests and Exploratory Costs
All costs incurred in acquiring petroleum leasehold interests, consisting primarily of bonus payments, are capitalized. When a lease is proved to be productive, its entire cost is transferred to productive petroleum properties. If a lease proves to be non-productive, the entire cost of the lease is charged against the reserve for unproved leasehold interests. This reserve is provided by amortizing the cost of unproved leasehold interests based on past experience. If the reserve for unproved leasehold interests is judged inadequate based on the results of exploratory drilling, additions are made to the reserve. Geological and geophysical costs, exploratory dry hole costs and annual delay rentals on unexplored leases are charged to income.

Depreciation and Depletion of Productive Petroleum Properties
Productive petroleum properties, consisting principally of tangible and intangible costs incurred in developing a property and costs of productive leasehold interests, are depreciated or depleted on a unit of production method based on annual estimates of remaining proved developed reserves or proved reserves, as appropriate, for each defined property. Certain other petroleum properties are depreciated on a straight-line basis.

Inventories
Supply inventories, consisting of approximately 92% of all inventories are valued at the lower of cost (average or first-in, first-out) or market. Inventories entering into the determination of cost of goods sold of the forest products and petroleum marketing operations are valued using the last-in, first-out method.

Federal Income Tax
Provisions for federal income tax recognize the tax effects of all transactions entering into the determination of income for financial reporting purposes irrespective of when such transactions are reported for federal income tax purposes.

Deferred federal income tax presented on the balance sheet does not represent a liability to the federal government. If the effect of timing differences in future years causes the currently payable federal income tax provision to exceed the total federal income tax provision, income will be credited for the amount of such excess with a corresponding reduction in deferred federal income tax.

Investment Tax Credits
Investment tax credits are included in income as a reduction of federal income tax in the year the related properties are placed in service.

Net Income Per Share of Common Stock
Primary net income per share of common stock is based on the weighted average number of shares of common stock outstanding during the year. Fully diluted net income per share of common stock gives effect to future conversions of convertible securities and the exercise of outstanding stock options.

Note 2: Federal Income Tax

The provision for federal income tax is computed as follows:

	1981	1980	1979
			(In Millions)
Income before federal income tax	$319.2	$429.1	$313.0
Statutory tax rate	46%	46%	46%
Tax at statutory rate	146.8	197.4	144.0
Less reductions for:			
Investment tax credit	51.1	55.9	47.3
Capital gain transactions	13.4	11.2	8.6
Other	5.3	3.0	2.8
Total	69.8	70.1	58.7
Total federal income tax	$ 77.0	$127.3	$ 85.3
Effective tax rate	24.1%	29.7%	27.3%
Effect of reductions on net income per share	$ .79	$ .81	$ .70

The provision for deferred federal income tax is comprised of the following tax effects of timing differences:

	1981	1980	1979
			(In Millions)
Additional depreciation for tax purposes	$ 58.3	$ 43.3	$ 32.4
Depreciation for tax purposes of unrecovered cost of track structure at December 31, 1980	95.8		
Excess of intangible drilling costs deducted for tax purposes over amortization of such costs capitalized for financial reporting purposes	34.6	21.2	12.9
Reduction for capital gain transactions tax benefit because of net operating loss in 1981 for tax purposes	(13.4)		
Other	(16.2)	7.4	(3.5)
Total deferred federal income tax	$159.1	$ 71.9	$ 41.8

The Economic Recovery Tax Act of 1981 (ERTA) resulted in $208.3 million of additional deductions in 1981 because of a provision which permits Santa Fe to depreciate the unrecovered cost of track structure at December 31, 1980 over a period of five years beginning in 1981 using accelerated methods and of $18.3 million because of increased depreciation deductions under the new Accelerated Cost Recovery System (ACRS) relating to properties placed in service subsequent to December 31, 1980. Because of these factors, Santa Fe will report a net operating loss in 1981 for federal income tax purposes which will result in a $93.1 million refund of federal income tax previously paid. Such refund arises principally as a result of carryback to prior years of the net operating loss and investment tax credit generated in 1981. At December 31, 1981, investment tax credits of $3.7 million are available to be applied against future years federal income tax liabilities.

ERTA also repealed, for tax purposes only, the "retirement-replacement-betterment" method of depreciation for track structure. Beginning in 1981, Santa Fe will be required to capitalize the cost of replacing track structure instead of deducting the cost as an operating expense. Costs capitalized in a year will be depreciated using accelerated methods over a one year period in 1981, two years in 1982, three years in 1983, four years in 1984 and five years in 1985 and thereafter.

All federal income tax matters for years prior to 1959 have been resolved. During 1980, the years 1954 to 1958 were settled which resulted in the receipt in January 1981 of a refund of $3.0 million (plus interest of $4.7 million).

The Internal Revenue Service (IRS) has completed its examination of returns filed for the years 1959 through 1976 and has proposed deficiencies aggregating $54.3 million, excluding interest thereon. Such amount is after reduction for $17.1 million of investment tax credits that have been realized as carryovers in returns filed for years subsequent to 1976. Since many of the issues involved in the above deficiencies will continue in years subsequent to 1976, it is anticipated that deficiencies will be asserted when IRS examinations of such years are completed.

However, claims are pending for refund of tax previously paid for the years 1959 through 1965 aggregating $13.6 million, excluding interest thereon. Claims for refund of tax previously paid for the years 1966 through 1976 will also be filed covering issues similar to those involved in the refund claims for the years 1959 through 1965.

The proposed and assessed deficiencies are being contested either through administrative appeal with the IRS or in the courts. Deficiencies asserted in connection with examinations currently in progress will be contested in a similar manner. While it is not possible to predict with certainty the results of the final settlement of prior year tax matters, in the opinion of tax counsel based, in part, on certain informal agreements reached with the IRS, the additional tax will be significantly less than the proposed or assessed deficiencies, with a significant portion of the anticipated settlement representing tax arising from differences in the timing of deductions for tax and financial reporting purposes. In the opinion of management and tax counsel, the resolution of possible federal income tax deficiencies will not have a material adverse effect on the consolidated financial position or results of operations of Santa Fe.

Note 3: Long Term Debt and Revolving Credit Agreement

Long term debt at December 31, 1981 and 1980 consists of the following:

	1981	1980
		(In Millions)
Santa Fe		
6¼% Subordinated Debentures due 1998	$ 16.2	$ 26.3
Subsidiaries		
4% General Mortgage and Adjustment Bonds due 1995	112.1	112.5
6⅞% to 15¼% Equipment Obligations due 1982 to 1996 (10% weighted average interest rate)	538.2	513.5
8.35% Debentures due 1988 to 2002	75.0	75.0
7¾% First Mortgage Bonds due 1982 to 1989	6.7	7.5
Bank and other loans due 1982 to 2003	25.3	96.0
Total long term debt	773.5	830.8
Due within one year	52.7	77.9
Due after one year	$720.8	$752.9

Projected principal repayments of long term debt during the five years 1982 through 1986 are $52.7 million; $55.4 million; $63.0 million; $56.6 million; and $46.1 million, respectively.

The 6¼% Subordinated Debentures are convertible prior to August 1, 1988 into 1,521,199 shares of common stock at $10.67 per share, subject to adjustment under antidilution provisions. The debentures may be called for redemption at the option of Santa Fe at any time, or in part from time to time, at principal amount plus accrued interest to date of redemption.

Approximately 11,000 route miles, all owned railroad equipment and substantially all railroad supporting facilities are subject to lien of the mortgages securing the 4% General Mortgage and Adjustment Bonds (Bonds). However, certain railroad equipment is subject to prior lien under equipment obligations. Interest on the Adjustment Bonds ($25.4 million principal amount outstanding at December 31, 1981) is contingent and payable from surplus net income of The Atchison, Topeka and Santa Fe Railway Company (Railway) for each year ended June 30. Interest not paid in any year is cumulative (none at December 31, 1981) and payable from future surplus net income.

In 1952 the Board of Directors of Railway (Board) created a Voluntary Bond Retirement Fund (Fund) for use in meeting the maturities of the non-callable Bonds. At December 31, 1981 the Fund, exclusive of Bonds held in the Fund, consists of $28.7 million of U. S. Government securities (market value of $27.3 million) and $.8 million of accrued interest. Such amounts give effect to the action taken on January 26, 1982 by the Board to remove from the Fund assets having a book value of $34.4 million at December 31, 1981. The projected earnings of the U. S. Government securities held in the Fund, when continually reinvested, should result in the accumulation of sufficient funds to retire the Bonds at maturity.

Since inception of the Fund, $77.9 million of Bonds ($.3 million in 1981) have been purchased by Railway at a cost of $55.9 million ($.1 million in 1981). For financial reporting purposes, such Bonds have been deducted from long term debt. In addition, $8.0 million of Bonds purchased by Railway prior to creation of the Fund and $9.6 million of Bonds purchased by Santa Fe Industries, Inc. in 1979 for investment purposes at a cost of $5.9 million are held in treasury and have been deducted from long term debt.

The 7¾% First Mortgage Bonds are secured by lien on the Gulf Central pipeline properties having a cost of $121.6 million at December 31, 1981.

On June 1, 1981 Santa Fe entered into a revolving credit agreement with a number of major banks under which it can borrow up to $150 million until May 31, 1985 at rates of interest equal to either (1) the prime rate of Morgan Guaranty Trust Company of New York or (2) the London Interbank Offered Rate (LIBOR) plus three-eighths of one percentage point, as selected by Santa Fe. A commitment fee of three-eighths of one percent per annum is required on the unused portion of the commitment. Santa Fe borrowed $50.0 million on January 15, 1982 under this agreement.

Note 4: Leases

Leased properties under capital leases presented in the accompanying balance sheet at December 31, 1981 represent the present value of future rental payments at the inception of the leases of $48.5 million, less accumulated amortization of $26.8 million computed on a straight-line basis over the terms of the related leases. Obligations under capital leases of $26.1 million represent the present value of future rental payments after deducting $4.9 million classified as a current liability.

A summary of capital lease arrangements and the aggregate future lease payments at December 31, 1981 follows:

			Future Lease Payments		
Year of Lease	Term in Years	Units Leased	Present Value	Imputed Interest	Total
					(In Millions)
1969	15	90 locomotives	$ 4.9	$ .8	$ 5.7
1974	18	53 locomotives	15.9	6.8	22.7
1977-78	8	874 trailers	4.1	.7	4.8
Other			6.1	3.3	9.4
Total			$31.0	$11.6	$42.6

Required payments under capital leases during the five years 1982 through 1986 are $6.8 million; $6.8 million; $5.7 million; $4.6 million; and $3.5 million, respectively.

Total rental expense for all operating leases was $48.5 million in 1981, $47.6 million in 1980 and $28.4 million in 1979. Minimum annual rental payments under non-cancellable operating leases during the five years 1982 through 1986 are $18.1 million; $13.3 million; $9.7 million; $9.1 million; and $8.2 million, respectively.

Note 5: Capital Stock, Stock Options and Shares Reserved

On April 28, 1981 stockholders approved a three-for-one split of Santa Fe's common stock effective May 11, 1981. All prior years data relating to common stock, net income per share, dividends per share and other per share data included in the financial statements or footnotes have been retroactively adjusted to give effect to the stock split. The par value was reduced from $10.00 to $3.33⅓ and the authorized common stock was increased from 50 million to 150 million shares. Stockholders also approved an amendment of the Certificate of Incorporation to authorize 20 million shares of Preferred Stock (none outstanding) issuable in one or more series with such designations, preferences, powers, and rights as the Board of Directors may determine at the time any such series is created. The amendment also removed the authorization for the previously outstanding cumulative preferred stock.

In October 1980, the $.50 Cumulative Preferred Stock was called for redemption at $10 per share plus dividends accrued of $.1014 per share of which 122,496 shares have been or will be redeemed while the remainder were converted into common stock.

During 1981, 143,019 shares of common stock having a fair market value of $4.6 million were issued under provisions of the Long Term Earnings Growth and Stock Ownership Plan (Growth Plan) approved by stockholders on May 22, 1979. Such shares are held in trust for future distribution to certain officers and key employees in accordance with the restrictive provisions of the Growth Plan. Under the Growth Plan, a maximum of 750,000 shares can be awarded. Through December 31, 1981, 282,174 shares have been awarded of which 132,090 shares were distributed on January 4, 1982.

On May 1, 1969 stockholders approved the Santa Fe stock option plan under which options could be granted until September 24, 1978 to officers and key employees to purchase shares of common stock at prices not less than 100% of market value at date of grant. Options to purchase an aggregate of 2,989,212 shares were granted under the plan and no additional options may be granted. Options granted expire five years after date of grant and became exercisable two years after date of grant. A summary of changes in stock options outstanding, which expire June 27, 1983, all of which were exercisable at $11.63 at the respective year ends, follows:

	1981	1980
January 1	99,795	390,825
Exercised	71,046	284,130
Cancelled	1,200	6,900
December 31	27,549	99,795

The par value of stock issued upon exercise of options is credited to the common stock account and the balance of the option price is credited to paid-in capital. Federal income tax benefits realized ($.3 million in 1981) as a result of employees' dispositions of stock option shares within three years from date of exercise are also credited to paid-in capital. No charges or credits are made to income in connection with the exercise of options.

At December 31, 1981, 2,035,729 shares of common stock were reserved for issuance upon conversion of 6¼% Subordinated Debentures, for exercise of stock options granted, and for issuance under the Growth Plan.

Note 6: Pension and Employee Benefit Plans

Pensions for all employees are provided under the Railroad Retirement Tax (RRTA) or the Federal Insurance Contributions Acts (FICA). Payments under these Acts charged to expense amounted to $124.7 million in 1981, $109.4 million in 1980 and $99.1 million in 1979.

In addition, a number of supplemental pension plans are in existence, the most significant of which is the trusteed, non-contributory Santa Fe Retirement Plan for substantially all officers and employees of Santa Fe and its subsidiaries not covered by collective bargaining agreements. Pension cost for this plan is determined by the aggregate cost method. Contributions, which approximate pension costs charged to expense, for the plan year beginning October 1, 1981 are estimated at $11.2 million compared with $18.7 million for the prior year. The decrease in contributions and in accumulated plan benefits presented below is due to an increase from 6% to 8% in the actuarial assumption relating to rate of return on investments and modification of the actuarial computation and assumptions relating to determination of the amount of RRTA and FICA benefits offset against benefits payable under the plan to participants upon retirement, partially offset by an increase from 4% to 6% in the actuarial assumption relating to salary rate increases.

Accumulated plan benefits and plan assets as of September 30, 1981 and 1980 (the valuation dates) are as follows:

	1981	1980
	(In Millions)	
Actuarial present value of accumulated benefits		
Vested	$179.1	$224.4
Non-vested	3.9	6.6
Total	$183.0	$231.0
Plan assets (at market) and balance sheet accruals	$169.2	$165.2

The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8% in 1981 and 6% in 1980.

Amounts charged to income for all supplemental pension plans were $20.7 million in 1981, $20.6 million in 1980 and $17.0 million in 1979.

The present value of future benefits under the trusteed non-contributory group life post-retirement insurance plan amounted to $35.9 million and $42.5 million at September 30, 1981 and 1980, respectively. Contribution to a trust for the plan year beginning October 1, 1981 was $2.5 million compared with $3.3 million for the prior year when the trust was established. The decline in the present value of future benefits and the contribution results principally from an increase from 6% to 8% in the assumed rate of return on investments.

Note 7: Other Income-Net

Other income-net consists of the following:

	1981	1980	1979
		(In Millions)	
Interest and dividend income	$32.5	$27.0	$34.5
Gain on purchase of outstanding Bonds (Note 3)	.2	.9	7.0
Gain (loss) on sale of Voluntary Bond Retirement Fund securities	3.2	.2	(.9)
Gain on sale of timberland under threat of condemnation	2.3	.3	.2
Unallocated corporate expenses	(12.6)	(10.8)	(8.6)
Other-net	3.0	5.4	2.3
Total	$28.6	$23.0	$34.5

Note 8: Accrued Liabilities

Accrued liabilities at December 31, 1981 and 1980 consist of the following:

	1981	1980
		(In Millions)
Vacations	$ 68.6	$ 61.2
Interest	16.2	18.6
Taxes, other than federal income tax	55.8	40.2
Other	162.1	138.4
Total	$302.7	$258.4

Note 9: Contingencies

Railway is (1) contingently liable as a guarantor, individually or jointly with other railroads, of principal (primary obligations of $3.9 million with other railroads having primary obligations of $27.1 million) and interest on certain obligations of various affiliated companies and (2) a participant with other railroads in a service interruption policy with maximum contingent premiums for the year ending August 31, 1982 of $45 million.

In connection with a leveraged lease transaction relating to the acquisition in 1975 of 1,000 freight cars by Railbox Company (Railbox), a wholly-owned subsidiary of a 4.8% owned affiliate, Railway guaranteed debt obligations ($14.0 million outstanding at December 31, 1981) and interest thereon. In addition, Railway has guaranteed the obligations of Railbox to make payments under the lease. In the event of default, Railway will become the lessee of the equipment. Rental payments under the lease are sufficient to satisfy the debt and interest obligations of the lessor.

Since 1973 Santa Fe's petroleum operations have been subject to federal regulation administered by the Department of Energy (DOE) or predecessor agencies. During 1979, the DOE completed an audit of a portion of Santa Fe's petroleum operations and asserted that overcharges under federal crude oil pricing regulations of $8.2 million (excluding interest) occurred from 1973 through 1977. During 1981 the DOE completed an audit of another portion of Santa Fe's petroleum operations and informally identified possible overcharges of approximately $5.3 million (excluding interest) for the period of September 1, 1973 through July 31, 1980. Because of decontrol of crude oil from pricing regulations and other factors, no further material liabilities, other than interest, should arise under such exceptions. Santa Fe has challenged and denied substantially all of the claims asserted by DOE on various factual and legal grounds. Accordingly, Santa Fe continues to believe that the reserve of $8.0 million established in 1979 is adequate to cover all possible refunds plus interest thereon.

In December 1981, Texas Utilities Company and its subsidiary, Chaco Energy Company, with which Santa Fe has a major long term coal lease agreement, brought an action against Santa Fe and others in the federal district court in Dallas, Texas, alleging violations of law in connection with certain coal lease agreements, including Santa Fe's. The complaint alleges that Santa Fe, certain of its subsidiaries, including Railway and Santa Fe Mining, Inc., and other parties fixed the price of coal in the San Juan Basin area of New Mexico, restricted competition in the production and sale of coal from this area, and fraudulently induced Texas Utilities Company to enter the coal lease agreement. The complaint asks the court to award treble damages in an unspecified amount and to declare the coal lease agreements unlawful, void and unenforceable. Santa Fe and its subsidiaries filed an action in the federal district court in New Mexico asking for a declaratory judgment that the coal lease agreement did not violate the antitrust laws, and that it was not induced by fraud and that such agreement is valid and enforceable. The Santa Fe lawsuit also requested a preliminary injunction restraining Texas Utilities and Chaco Energy Company from proceeding with their action in Texas. On January 11, 1982, the New Mexico federal court entered such an injunction, as requested by Santa Fe, holding that the only proper place for such litigation was in New Mexico. On February 2, 1982, Texas Utilities and Chaco Energy Company filed an appeal from the entry of the injunction to the Court of Appeals for the 10th Circuit. On February 8, the Court of Appeals entered an order staying the New Mexico Court's injunction, pending appeal, and setting an expedited schedule for determination of whether the preliminary injunction should be affirmed. In the opinion of Santa Fe, this proceeding will not have a material adverse effect on the consolidated financial position or results of operations of Santa Fe.

Santa Fe is a party to a number of other legal actions arising in the ordinary course of business. In the opinion of management and legal counsel, Santa Fe has adequate legal defenses regarding these actions or has established adequate reserves, and does not believe the final resolution of these actions will have a material adverse effect on the consolidated financial position or results of operations of Santa Fe.

Note 10: Petroleum Producing Operations

Reserve Quantities (Unaudited)
Presented below are the proved crude oil and natural gas reserves (all located in the United States) of Santa Fe's petroleum producing operations. Reserve quantities as well as information regarding future net revenues and the present value of future net revenues were determined by Riggs and Associates, Inc., an independent petroleum consultant.

	Crude Oil			Natural Gas		
	1981	1980	1979	1981	1980	1979
	(Million barrels)			(Billion cubic feet)		
Proved reserves:						
Beginning of year	141.6	137.4	130.5	170.1	161.0	135.8
Changes during the year						
Revisions of previous estimates	1.9	1.3	14.7	(.2)	.1	8.6
Improved recovery	4.2	11.1	6.0	.4	.3	.5
Extensions, discoveries and other additions	5.5	7.1	2.7	27.5	20.8	28.1
Production	(15.6)	(15.3)	(16.5)	(14.7)	(12.1)	(12.0)
End of year	137.6	141.6	137.4	183.1	170.1	161.0
Proved developed reserves	124.2	128.7	126.3	162.3	149.3	141.9

Proved developed reserves at January 1, 1979 were 114.3 million barrels of crude oil and 128.1 billion cubic feet of natural gas.

Capitalized Costs
Santa Fe follows the "successful efforts" method of accounting for its petroleum producing operations. Total capitalized costs and accumulated depreciation, depletion and amortization related to petroleum producing operations follow:

As of December 31	1981	1980	1979
			(In Millions)
Capitalized costs	$811.4	$583.9	$454.7
Accumulated depreciation, depletion and amortization	236.5	177.7	141.1

Costs Incurred in Petroleum Producing Operations
Costs incurred in petroleum producing operations follow:

For the Year	1981	1980	1979
			(In Millions)
Leasehold interests acquisition costs	$ 59.9	$13.1	$17.5
Exploratory costs	117.6	64.7	40.5
Development costs	140.8	85.0	56.0
Production (lifting) costs	111.3	83.8	49.9
Windfall Profit Tax	81.4	37.3	
Depreciation, depletion and amortization	62.1	33.8	27.1

Revenues From Petroleum Producing Operations
Gross and net revenues from producing petroleum follow:

For the Year	1981	1980	1979
			(In Millions)
Gross revenues	$474.9	$355.3	$205.6
Less:			
Production (lifting) costs	111.3	83.8	49.9
Windfall Profit Tax	81.4	37.3	
Net Revenues	$282.2	$234.2	$155.7

Future net revenues from estimated production of proved crude oil and natural gas reserves (Unaudited)
Presented below are future net revenues (before general and administrative expenses and federal income tax) from estimated production of proved and proved developed crude oil and natural gas reserves for each of the three years ending December 31, 1982 through 1984, and thereafter in the aggregate.

	Proved Reserves	Proved Developed Reserves
		(In Millions)
Year ending:		
December 31, 1982	$ 271.3	$ 276.6
December 31, 1983	260.1	253.0
December 31, 1984	233.3	222.0
Thereafter in the aggregate	1,744.5	1,482.0
Total	$2,509.2	$2,233.6

The above does not represent a forecast of future net revenues or the current value of proved crude oil and natural gas reserves.

Pursuant to procedures prescribed by the Securities and Exchange Commission (SEC), gross revenues were determined on a property-by-property basis by applying prices in effect as of November 1, 1981 to the estimated future production of proved reserves except that price increases for natural gas were reflected to the extent provided by contractual arrangements.

No effect has been given to the following factors which could result in fluctuations in gross revenues subsequent to December 31, 1981:

(1) Changes in crude oil prices; and

(2) Increases in natural gas prices permitted under the Natural Gas Policy Act of 1978. This Act also provides for eventual price deregulation of certain categories of natural gas.

Accordingly, because of the above factors, gross revenues from estimated future production from proved reserves may vary significantly from gross revenues actually received in future years from the production of proved reserves at December 31, 1981.

Net revenues were determined by deducting production (lifting) costs, Windfall Profit Tax and future development costs from gross revenues. Production (lifting) costs were determined on a property-by-property basis on actual costs incurred during the first nine months of 1981 and future development costs relating to proved undeveloped reserves were based on costs in effect at December 31, 1981.

Consistent with procedures prescribed by the SEC, net revenues give no effect to (1) general and administrative expenses, (2) state income tax, or (3) federal income tax. Federal income tax on the excess of net revenues over the tax basis of oil and gas properties applicable to proved reserves at December 31, 1981 would be $1,068.2 million (based on a 46% statutory tax and reduced for investment tax credit on future development costs).

Present Value of Future Net Revenues (Unaudited)
Presented below is the present value of future net revenues from estimated production of proved and proved developed crude oil and natural gas reserves. As prescribed by the SEC, present value was determined by applying a 10% annual discount factor to future net revenues.

As of December 31	1981	1980	1979
			(In Millions)
Proved reserves	$1,469.2	$1,401.5	$1,369.3
Proved developed reserves	1,353.6	1,321.3	1,265.9

The present value of future net revenues as of December 31, 1981 and 1980 has been reduced for Windfall Profit Tax. The present value, as of December 31, 1979 of the decrease in net revenues from the Windfall Profit Tax would have amounted to $235.8 million. Such amounts were excluded in 1979 from the present value of future net revenues computation in accordance with SEC regulations. Federal income tax applicable to the present value of proved reserves at December 31, 1981, 1980 and 1979 computed on the same basis as described under "Future net revenues from estimated production of proved crude oil and natural gas reserves" amounts to $590.1 million, $564.8 million and $553.4 million ($445.0 million if reduced for the effect of the Windfall Profit Tax), respectively.

The above amounts do not represent the current value of proved crude oil and natural gas reserves or the costs that would be incurred to obtain equivalent reserves. Since the amounts are derived based on estimated future revenues, reference is made to the explanations under "Future net revenues from estimated production of proved crude oil and natural gas reserves" immediately preceding this section.

Summary of Petroleum Producing Operations on the Basis of Reserve Recognition Accounting (Unaudited)

The following summary sets forth (1) reconciliation of the change in net present value of proved reserves between the beginning and the end of the years 1979 through 1981, (2) a summary of the results of petroleum producing operations for such years on the basis of reserve recognition accounting (RRA), and (3) the cash flow from petroleum producing operations for such years. Under RRA, income is recognized at the time proved reserves are determined based on the present value of such reserves. Evaluated exploration and development costs related to the finding of reserves are charged against income. Also reflected in income are changes in the present value of proved reserves due to (1) price and cost increases, (2) increases in reserves due to price increase, (3) changes in reserve estimates for various factors, (4) changes in estimated future annual production of proved reserves at the beginning of the year and (5) elimination of one year's discount factor reflected in the beginning of the year present value of proved reserves.

	1981			1980			1979		
	Net present value of proved reserves	Petroleum results under RRA	Cash Flow	Net present value of proved reserves	Petroleum results under RRA	Cash Flow	Net present value of proved reserves	Petroleum results under RRA	Cash Flow
									(In Millions)
Additions to proved reserves, net (a)	$ 62.3	$ 62.3		$ 77.4	$ 77.4		$ 64.3	$ 64.3	
Revisions of net present value of proved reserves due to:									
Changes in prices increasing net present value of proved reserves at end of year, net (a and b)				115.1	115.1		661.5	661.5	
Other (c)	115.7	115.7		149.1	149.1		242.9	242.9	
Elimination of interest factor reflected in present value of reserves at beginning of year	140.2	140.2		136.9	136.9		47.9	47.9	
	318.2	318.2		478.5	478.5		1,016.6	1,016.6	
Evaluated acquisition, exploration and development costs, including impairments (d)		(229.1)	$(286.6)		(114.4)	$(139.1)		(70.9)	$(84.0)
Expenditures during the year that reduced estimated development costs considered in determination of net present value at beginning of year	31.7		(31.7)	23.7		(23.7)	30.0		(30.0)
Sales of petroleum, net of production (lifting) costs and Windfall Profit Tax	(282.2)		282.2	(234.2)		234.2	(155.7)		155.7
		89.1(e)	(36.1)		364.1(e)	71.4		945.7(e)	41.7
Provision for federal income tax		(78.6)	(53.3)		(177.8)	(57.1)		(439.8)	(47.4)
Increase in present value of proved reserves	67.7			268.0			890.9		
Present value at beginning of year	1,401.5			1,369.3			478.4		
Present value of Windfall Profit Tax as of January 1, 1980				(235.8)					
Present value at end of year	$1,469.2			$1,401.5			$1,369.3		
Petroleum results for the year under RRA		$ 10.5			$ 186.3			$ 505.9	
Net cash inflow (outflow) for the year for petroleum producing operations			$ (89.4)			$ 14.3			$ (5.7)

(a) Amounts are net of future production (lifting) costs and development costs.

(b) Includes increases in proved oil reserves of .6 million and 9.1 million barrels in 1980 and 1979, respectively and of proved natural gas reserves of 1.1 billion cubic feet in 1979 due to price increases which resulted in an increase in the present value of net revenues of $5.2 million and $29.3 million (increase in net revenues of $8.3 million and $185.0 million) in 1980 and 1979, respectively.

(c) Includes (1) effect of differences between estimated production, prices and costs for the year used to determine net present value at the end of the previous year and actual production, prices and costs for the year, (2) revisions in reserve estimates due to factors other than price changes, (3) effect of changes in estimated future annual production of proved reserves at the beginning of the year and (4) revisions in production (lifting) costs and development costs subsequent to year end due to inflation and other factors.

(d) At December 31, 1981, 1980 and 1979, deferred acquisition, exploration and development costs relating to properties being developed for which proved reserves had not been determined aggregated $120.6 million, $63.1 million and $38.4 million, respectively.

(e) Since under RRA income is recognized at the time of the discovery of proved reserves and as their value changes, no income is recognized at the time of production. Therefore, RRA earnings differ substantially in concept and amount from earnings reported under generally accepted accounting principles. Of the $134.8 million, $159.0 million and $106.9 million shown in Note 12 as operating income of the Natural Resources segment in 1981, 1980 and 1979, respectively, $120.9 million, $145.2 million and $94.0 million relate to petroleum production operations. Such amounts are not comparable to the $89.1 million, $364.1 million and $945.7 million pre-tax results under RRA for 1981, 1980 and 1979, respectively.

Note 11: Summarized Quarterly Operating Results (Unaudited)

	1981				1980			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Revenues and Sales(1)	$829.5	$862.7	$862.8	$811.9	$717.6	$766.2	$811.9	$827.1
Operating Income(2)	109.9	97.5	92.5	54.4	83.4	94.1	134.1	156.9
Net Income(3)	68.1	59.0	59.9	55.2	52.3	61.0	84.6	103.9
Net Income Per Share								
Primary	.77	.67	.67	.62	.61	.70	.97	1.19
Fully Diluted	.76	.65	.66	.61	.58	.68	.94	1.15

(1) 1980 restated to reflect the trading activities of the petroleum marketing operations on a net basis.
(2) 1980 restated to exclude state income taxes.
(3) Fourth quarter 1981 net income includes a $19.9 million benefit representing the cumulative effect resulting from a downward revision in the effective tax rate for the entire year 1981 from 31.4% at September 30, 1981 to 24.1% at December 31, 1981 due to lower than anticipated pre-tax income for the three months ended December 31, 1981.

Note 12: Information on Business Segments

	1981	1980	1979
			(In Millions)
Revenues and sales			
Transportation	$2,472.3	$2,337.7	$1,981.9
Natural resources	497.5	390.1	223.0
Forest products	149.9	137.0	131.5
Real estate and construction	247.2	258.0	219.2
Consolidated	$3,366.9	$3,122.8	$2,555.6

Intersegment sales are immaterial and no one customer accounts for 10% or more of consolidated revenues and sales.

For the years 1979 through 1981, rail operations contributed from 93% to 95% of total transportation revenues and petroleum production operations contributed from 91% to 96% of total natural resources revenues.

	1981	1980	1979
			(In Millions)
Operating income			
Transportation	$184.1	$257.5	$178.9
Natural resources	134.8	159.0	106.9
Forest products	3.1	9.7	16.3
Real estate and construction	32.3	42.3	25.9
Consolidated	$354.3	$468.5	$328.0
Contribution to income before income taxes			
Transportation	$136.0	$211.0	$135.4
Natural resources	134.8	159.0	105.3
Forest products	1.2	8.6	15.3
Real estate and construction	32.0	42.2	25.6
Corporate			
Other income-net	28.6	23.0	34.5
Unallocated interest expense	(1.2)	(2.4)	(3.1)
Consolidated	$331.4	$441.4	$313.0

Contribution to income before income taxes of each segment represents operating income less interest expense incurred directly by each segment. Interest expense incurred by the parent is not allocated to the segments.

	1981	1980	1979
			(In Millions)
Identifiable assets			
Transportation	$3,367.0	$3,265.6	$2,950.6
Natural resources	770.8	532.2	376.0
Forest products	186.1	176.2	159.4
Real estate and construction	161.5	152.2	149.1
Corporate	192.4	204.0	248.0
Consolidated	$4,677.8	$4,330.2	$3,883.1
Capital Expenditures			
Transportation	$ 282.4	$ 321.3	$ 318.2
Natural resources	256.1	142.3	99.9
Forest products	12.9	21.6	53.9
Real estate and construction	12.5	9.1	17.7
Consolidated	$ 563.9	$ 494.3	$ 489.7
Depreciation, depletion and amortization expense			
Transportation	$ 107.4	$ 99.4	$ 87.8
Natural resources	64.2	34.9	27.1
Forest products	10.1	8.2	6.6
Real estate and construction	2.9	2.5	2.6
Consolidated	$ 184.6	$ 145.0	$ 124.1
Repairs and replacement of track structure (Note 1)	$ 161.9	$ 164.0	$ 150.8

Note 13: Supplementary Information on Changing Prices (Unaudited)

The following supplementary information is presented as an alternative to historical cost accounting in accordance with the provisions of the Financial Accounting Standards Board Statements on Financial Reporting and Changing Prices. These statements were issued in response to the belief that financial statements prepared in accordance with generally accepted accounting principles based on historical cost measurements fail to reflect the effects of inflation which results in an overstatement of profits.

Two methods for measuring the effects of inflation are prescribed by these statements. The first measures the effects of general inflation (constant dollars). The second measures the effects of changes in specific prices of resources used in an enterprise (current cost).

The constant dollar data restate historical costs to equal units of purchasing power using the Consumer Price Index for all Urban Consumers. Current cost information is an estimate of dollars necessary to replace Santa Fe's current productive capacity. The current cost of fixed assets was determined through application of specific or internally generated indices to historical costs, vendor quotes, and other methods as deemed appropriate.

Comparison of selected financial data adjusted for effect of changing prices

	1981	1980	1979	1978	1977
			(In millions of average 1981 dollars)		
Sales and revenues					
As reported	$ 3,366.9	$ 3,122.8	$ 2,555.6	$2,098.7	$1,850.4
Constant dollars	3,366.9	3,446.7	3,202.1	2,925.7	2,777.1
Net income (a)					
As reported	$ 242.2	$ 301.8	$ 227.7		
Constant dollars	46.9	170.7	147.1		
Current cost	38.6	137.3	105.6		
Net income per share—primary (a)					
As reported	$ 2.73	$ 3.47	$ 2.69		
Constant dollars	.53	1.96	1.74		
Current cost	.44	1.58	1.24		
Dividends declared per share					
As reported	$ 1.00	$ .90	$ .82	$ .73	$ .70
Constant dollars	1.00	.99	1.03	1.02	1.05
Purchasing power gain from net monetary liabilities (b)	$ 120.5	$ 160.5	$ 166.9		
Unrecognized gains on properties held during the year due to:					
Increases in the general price level	$ 929.9	$ 1,248.2			
Increases in specific prices greater (less) than increases in general price level	343.2	(122.1)			
Total unrecognized gain	$ 1,273.1	$ 1,126.1			
Net assets at December 31 (c)					
As reported	$ 2,471.5	$ 2,305.5	$ 2,064.8		
Constant dollars	7,341.8	7,309.5	6,770.7		
Current cost	10,008.5	9,660.9	9,629.0		
Net properties, including properties under capital leases, at December 31					
As reported	$ 3,734.5	$ 3,395.6	$ 3,078.4		
Constant dollars	8,555.8	8,447.3	8,040.7		
Current cost	11,222.5	10,798.7	10,819.8		
Market price of common share at December 31					
As reported	$ 21.13	$ 34.17	$ 17.33	$ 9.83	$ 13.29
Constant dollars	20.45	36.02	20.53	13.20	19.45
Average Consumer Price Index	272.4	246.8	217.4	195.4	181.5

(a) The difference between net income, as reported, and net income for constant dollars or current cost represents the increase in depreciation, depletion and amortization expense which would arise when such expenses are based on assets restated to a constant dollar or current cost basis.

Since such increase in depreciation expense is not an allowable deduction for federal income tax purposes, no adjustment has been made to the provision for federal income tax as reported. As a result, the 1981 effective federal income tax rate under constant dollar and current cost is 62.1% and 66.6%, respectively, compared to 24.1% as reported.

As explained in Note 1, track structure is not depreciated but the current cost of replacing track structure is charged to expense. As a result, historical cost net income includes a charge which management believes is indicative of the current annual cost of replacing the expired productive capacity of track structure and is comparable to depreciation expense computed on track structure stated in either constant dollars or current cost. Furthermore, no adjustment has been made to inventories due to the immateriality of inventories in relation to total assets.

(b) The purchasing power gain results from an excess of monetary liabilities over monetary assets. Monetary assets are cash and claims to cash and monetary liabilities are liabilities fixed in terms of dollars and deferred federal income tax. In periods of inflation, monetary assets lose purchasing power because such assets will buy less goods and services than previously. Conversely, monetary liabilities gain purchasing power since dollars with reduced purchasing power will be used to extinguish such liabilities.

(c) The difference between net assets as reported and net assets on a constant dollar and current cost basis represents the increase in properties and leased properties under capital leases resulting from restatement of such properties and accumulated depreciation, depletion and amortization on a constant dollar and current cost basis.

(d) Demonstrated coal reserves at December 31, 1981, 1980 and 1979 were 827 million, 628 million and 611 million tons, respectively. The average price per ton received for coal was $2.78 in 1981, $2.08 in 1980 and $1.48 in 1979. Such amounts represent royalties under coal lease agreements. See Note 10 for an analysis of crude oil and natural gas reserves.

Directors

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President, The Atchison, Topeka
and Santa Fe Railway Company
Chicago, Illinois

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Senior Vice President-Executive
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The Atchison, Topeka and Santa Fe
Railway Company and Vice President
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Chicago, Illinois

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construction and materials handling
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Peoria, Illinois

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Carter Hawley Hale Stores, Inc.
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San Francisco, California

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Partner, Sisco Associates
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Chicago, Illinois

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• Compensation and Benefits Committee
▲ Audit Committee
Nominating Committee

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Senior Vice President-Law

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Vice President

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Vice President, Washington, D.C.

Jerome F. Donohoe
General Counsel-Corporate Affairs

Richard K. Knowlton
General Counsel-Transportation

Gus Svolos
General Counsel-Litigation

John W. Hayes
Secretary

Corporate Information

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C. J. Nassimbene, President

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R. T. Zitting, President

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D. W. Hall, President

Robert E. McKee, Inc.
P.O. Box 35848
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(214) 357-4381
C. E. Turner, President

Annual Meeting
The annual meeting of stockholders will be held in the Great Hall of the Americana Congress Hotel
520 South Michigan Avenue
Chicago, Illinois, on Tuesday
April 27, 1982 at 10:00 A.M.

Shares Listed
New York Stock Exchange
Midwest Stock Exchange
Ticker Symbol: SFF

Corporate Office
224 South Michigan Avenue
Chicago, Illinois 60604
(312) 427-4900

Registrars
For common stock:
Morgan Guaranty Trust Company of New York
23 Wall Street, New York 10015

For convertible debentures:
Santa Fe Industries, Inc.
120 Broadway, New York 10271

Transfer Agent
D. C. Shonkwiler
Santa Fe Industries, Inc.
120 Broadway
New York 10271

Dividend Reinvestment Service
Santa Fe provides an automatic dividend reinvestment service to common stockholders as a convenient method of investing Santa Fe dividends. If you would like a booklet describing this service, please write the Transfer Agent.

Form 10-K and Fact Book
To receive without charge a copy of the Company's Form 10-K annual report to the Securities and Exchange Commission, and the Santa Fe Fact Book containing financial and statistical information write:

J. W. Hayes, Secretary
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

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